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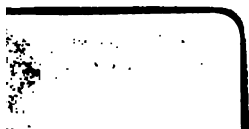
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E L E M E N T S
OF
POLITICAL ECONOMY.

THE
ELEMENTS
OF
POLITICAL ECONOMY.

BY
HENRY DUNNING MACLEOD.

Ne nous imaginons pas que le vrai soit victorieux dès qu'il se montre ; il l'est à la fin, mais il
lui faut du temps pour soumettre les esprits.

FONTENELLE. *Vie de Cornelle.*

LONDON:
LONGMAN, BROWN, GREEN, LONGMANS, AND ROBERTS.

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PREFACE.

The purpose of the following work is to strengthen and establish the new conceptions and principles in Political Economy propounded in my *Theory and Practice of Banking*. In order to treat that subject properly, I found it necessary to lay altogether new foundations of the science. But I was subject to a certain disadvantage. For to establish a new set of opinions, an unusual amount of discussion and controversy is necessary. But to do this in a thoroughly efficient manner, would have led to an inordinate increase of a work, whose plan already extended over a wide range of subjects. I was, therefore, in a certain measure cramped to a more confined discussion than the nature of the case really demanded, to have justice done to it. The object, therefore, of the present work is to widen and strengthen the foundations of the science, as treated in that work. It has, therefore, a very considerable portion in common with it; and those parts of the former work, which are of general application, are incorporated with this one.

The view that I take of the proper limits of the pure science of Political Economy, entirely differs from that

of any of the larger and well-known Treatises on it. In my view the true object of the pure science of Political Economy is to *discover the laws that regulate the Exchangeable Relations of Quantities*. This coincides, I think, pretty closely, with the ideas of at least one eminent writer—Archbishop Whately. I however think it right to say, that I formed this opinion of the subject quite independently, and, indeed, before I was acquainted with his lectures. The same conception seems also to have occurred to other writers, but no one has hitherto executed a comprehensive work, founded upon this conception. The views held by preceding writers, and the reasons which have led me to endeavour to found a system on this conception, are shortly stated in the preliminary observations.

Political Economy, like geology, is preeminently a practical science. There is no more grievous error, than to suppose that it can be constructed solely in the closet, like some abstract sciences. On the contrary, it requires a familiar practical knowledge of a considerable variety of subjects. Nature is far more subtle than the acutest intellect of man, says Bacon, and in practice there occur a great variety of circumstances of the first importance in Political Economy, but which would only occur to a person practically familiar with the subject. Moreover it is indispensably necessary that these facts, and their relations, should be expressed in language governed by the most rigorous scientific precision.

The forces which produce the phenomena of Political Economy are equally certain, precise, and unerring, as those in Mechanics, and they must be expressed in language subject to the same scientific control. Political Economy will never be brought to a satisfactory state, until the meaning of every single term is as rigidly set-

tled, and every sentence and idea is tested with the same rigorous precision as those in mechanics. And success in one depends exactly on the same faculty as in the other, namely the power of the separation of ideas, of resolving complex ideas into their elements. “Nella maggior parte degli uomini manca il vigore per rimontare ai principii grandi e universali, e scomporre con analisi le mal combinate idee, unico mezzo per scoprire le vere relazioni delle cose.”*

It is a glorious and a hopeful sign to see the writings of Bacon daily becoming more popular. This, of course, is not the place to go into any general account of his transcendent merits. But one of them bears peculiarly on our present subject. He diligently inculcated the doctrine of the unity of science. His name has been far too much exclusively connected with physical Science, whereas he over and over again inculcates that natural philosophy is the proper preparation and discipline for the successful study of moral and political science. He calls it the “admirable mother of the sciences,” and again and again declares, that the same general principles of reasoning lie at the foundation of all science, and warns us on no account whatever to break the continuity of the Sciences. “Atque hoc pro regulâ ponatur generali; quod omnes scientiarum partitiones ita intelligantur et adhibeantur, ut scientias potius signent aut distinguant, quam secent et divellant; ut perpetuo evitetur solutio continuitatis in scientiis. Hujus etenim contrarium particulares scientias steriles reddidit, inanes et erroneas; dum a fonte et fomite communi non aluntur, sustentantur et rectificantur.”†

* Beccaria. Del Disordine delle Monete nello Stato di Milano. 1762.

† De Augm: Sci: L. IV. Cap. 1.

That the same great principles of reasoning are common to all sciences, is a truth which is now so generally acknowledged, as to require nothing to be said. If, therefore, it can be shewn, that the arguments of writers on Political Economy are palpable violations of all the acknowledged standards of reasoning in Natural Philosophy, that is enough at once to condemn them. Now, this is exactly what is the case with the principal works on Political Economy, which have exercised the greatest influence over opinion in recent times.

Ricardo was a person of great natural powers of reasoning, but unfortunately, as is well known, he never received that indispensable training in natural science, without which, it is absolutely hopeless that any one whatever, however great his natural abilities may be, can construct a work on scientific principles. "Neither the naked hand, nor the undisciplined intellect, can avail much," says Bacon, "each of them requires instruments and training." Though his work, therefore, shews his great aptitude for abstract reasoning, it is not possible for any one who understands the great general principles of natural philosophy, not to see immediately, that it is diametrically opposed to them. It is a complete rupture of that continuity of science, which is universally acknowledged to be indispensable. To believe in Ricardo at the present day is a most grievous anachronism. No work whatever from its great, but undisciplined power, has inflicted such incalculable mischief on the Science of Political Economy.

Bacon declares that all science consists in forming true conceptions of things, and discovering the laws of their relations, or general principles, the *notiones* and the *axiomata*. He maintains that the discovery of these

depends upon the same general methods, and the same tests must be applied for proving their accuracy. One of the chief methods is that of rejections and exclusions. Having stated this, however, his attention has been chiefly directed to the method of ascertaining correct axioms, or general principles, and he has said very little about the conceptions, or definitions. And most persons who have cultivated natural philosophy, have bestowed much more attention to the principles, than the conceptions. But we shall find that Political Economy affords many instances of striking beauty, in which the great truths chiefly brought to bear by him on principles, are here brought to bear on conceptions.

By that mysterious correlation which holds between reasoning and reality, it is invariably found that if conceptions of things are framed which are true to nature, and results are calculated according to reasoning which is also true to nature, they will be found to correspond to reality. That is, if true conceptions are formed, and truly reasoned about, results may be *predicted*. But if results are calculated, and it is found that they do not correspond to nature, but are palpably and notoriously erroneous, then we are immediately certain, either that the reasoning, or the conception, must be erroneous. And if it be shewn that the reasoning is unimpeachable, it necessarily follows that the conception *must* be untrue.

We shall find a most beautiful exemplification of this, in the common notions about the paper currency and money. The common notion is that the paper currency merely represents bullion, as an article of value, not because there is any speciality about bullion in itself, but merely as a convenient commodity. Now, adopting this notion, there is a very prevalent idea, which is the

peculiarity of John Law's theory of money, that a paper currency may represent any other article of value, equally well as bullion, and that if there is a scarcity of bullion, the only thing necessary to insure an ample supply of money, is to base a paper currency upon any other commodity of value. Now, the *reasoning* is unanswerable if a paper currency is the representative of *value*, Law's theory of money cannot be refuted. What he says is that if a paper currency only represents an article of value it cannot be depreciated. Now, there is no flaw whatever in his reasoning. And his plan appearing to be so specious, has been repeatedly tried, and as uniformly failed, inducing some of the most terrible convulsions the world ever saw. It, therefore, *must* be erroneous, and as we have said the reasoning is unimpeachable, the error *MUST* lie in the conception.

We must proceed by Bacon's method of rejections and exclusions. If a paper currency succeeds, which is based solely upon bullion, and fails when based upon bullion and commodities, which are both articles of value, it necessarily follows that we must search for some conception, which shall *include* bullion and *exclude* commodities. And that is precisely what we have done. We have found that a paper currency is based upon bullion as the specific representative of *debt*, and not as an indifferent article of value. Bullion is the representative of debt, and commodities are not. Paper currency is the representative of debt. Paper currency and bullion are homogeneous quantities, paper currency and commodities are *not* homogeneous. Directly we adopt the conception of currency as the representative of debt, the fallacy of Law's theory of money is palpable, and apparent. It is immediately seen that to base a paper currency on commodities, is an express violation of this fundamental con-

ception. It is immediately seen that it involves this contradiction in terms, *that we can buy a thing and have the price of it as well*. It is also seen that by adopting our conception of the nature of money, all the direful consequences which we know have occurred, can be infallibly predicted, it can be shewn that they must necessarily happen. There can then be no possible doubt that we have at last obtained the true conception of the nature of a currency. *Currency is the representative of DEBT and not of VALUE.*

Now, this result is not doubtful, or a matter of opinion, but it is a certainty. It is attained by exactly the same process of reasoning that all results which are acknowledged to be certain are attained. It is just as certainly wrong to say that paper currency is the *representative of value*, as it is certainly wrong to say that the sun goes round the earth. The certainty of the one result depends upon exactly the same principle as the other, namely, the capability of shewing that results obtained by reasoning founded upon such conceptions, necessarily correspond with actual phenomena.

There is no science so apt to seduce and deceive an unwary person as Political Economy. In most other sciences the terms are uncouth, novel, and strange. They immediately arrest the learner's attention, and he desires to ascertain their exact meaning. Having learnt this, he always associates certain definite ideas with certain words. In Political Economy, however, the words being in common use are so familiar that people use the language carelessly, and never dream of stopping to think whether they have any definite idea of the meaning of the words they employ.

The consequence is, that the language of Political Economy is utterly corrupt. The first thing to be done, is to

effect a thorough and entire reform of the nomenclature of the subject; to fix and define the true conception of all its technical terms on exactly the same principles as they are done in other sciences.

"In the right definition of names lies the first use of speech, which is the acquisition of science. And in wrong, or no definitions, lies the first abuse, from which proceed all false and senseless tenets." So says Hobbes,* nor did any man ever say anything more true. And a writer, who it would have been well if he had followed his sentiments more closely, says: "But to penetrate to the more hidden agreement on which these obvious and superficial agreements depend, is often one of the most difficult of scientific problems. As it is among the most difficult, so it seldom fails to be among the most important. And since upon the result of this inquiry respecting the causes of the properties of a class of things, there incidentally depends the question, What shall be the meaning of a word, some of the most profound and valuable investigations, which philosophy presents to us, have been introduced by, and have offered themselves under the guise of inquiries into the definition of a name."†

And this is as applicable to Political Economy as to any other science, though it has been less attended to. The question whether the circulating medium is the medium which circulates itself, or the medium which circulates commodities, is of fundamental importance. No progress can be made until the question, whether Bills of Exchange are, or are not, circulating medium, is conclusively settled on scientific principles.

Nothing can shew better than Political Economy, the

* *Leviathan*. Pt. I. chap. iv.

† J. S. Mill. *System of Logic*. Vol I. p. 175.

extraordinary importance and the powerful effect this correct, or incorrect language has upon men's opinions. If thought does not master language, language will soon master thought, and govern action. The consequences of wickedness, crimes, folly, and destruction, does the expression the "Balance of Trade" and the Law have made some of the most astonishing examples in Natural Science, before they discovered the simple fact that in commerce both sides must gain.

If, then, it is of so great importance to settle the nomenclature of the Science, the first requisite is manifestly to endeavour to settle the true conception of the Science itself. Accordingly, in the PRELIMINARY OBSERVATIONS, I have very briefly stated the circumstances out of which it originated, the views of its nature and extent which the chief writers in it have held, and the reasons which have led me to adopt the conception of it as the Science which treats of the laws that regulate the Exchangeable relations of quantities.

The FIRST Chapter, then, contains an attempt to settle the true fundamental conceptions of the various terms and objects in it, fortifying and illustrating these views by analogous instances drawn from other sciences.

The SECOND Chapter then attempts to settle the general laws, which regulate the exchangeable relations of these quantities, on exactly similar principles as are acknowledged to be conclusive in physical science. Though I would willingly have avoided controversy, I thought it incumbent on me, to shew that the principles of other writers which I dissent from, are clearly and manifestly opposed to the principles of general science. The question, therefore, does not lie between me and them, but is to decide which of our opinions is correct, according to a universally recognized standard of reference. Having

attained such a general principle, its application is shewn in two Sections. The first treats of its application to cases of absolute sale, the second to those of the temporary purchase for any time of the use of anything. In this latter Section I have endeavoured to shew that Ricardo's fundamental conception of Rent is not the true one, and also that the general principle he arrives at is palpably erroneous.

The THIRD Chapter treats of CREDIT. No subject has been so grievously maltreated by Political Economists as Credit. Turgot is the great misleader of opinion on this point, and all his error, and that of succeeding writers, proceeds from a conception of the nature of Credit, which is palpably absurd. Credit is divided into two grand divisions, Mercantile Credit, and Banking Credit. In two sections I have endeavoured to exhibit as correctly as possible, the actual details of business; a thing which has never yet been done, by any writer on Political Economy. Mercantile Credit occupies the first Section.

The second Section is of peculiar importance at the present time, when Banking occupies the public attention so prominently; and all the more so, in consequence of the erroneous notions which are prevalent upon it. I have carefully read every word that ever was said in Parliament upon it; everything contained in the various blue books; innumerable pamphlets; quantities of articles in newspapers, and I can only say this, that not a single speaker in Parliament, not a single witness before a Parliamentary committee, not a single pamphleteer, not a single writer of a newspaper article shewed, that he had the most distant conception of the ordinary routine business of banking! The actual details are here for the first time exhibited, and it is only necessary to under-

stand them to see that they contain a complete overthrow of common opinion on the subject.

The third Section I have devoted to the examination of the established doctrines on the subject of Credit, from Turgot to Mr. Mill, and shewn the entirely false conception of the nature of Credit, they are based upon.

The FOURTH Chapter contains less novelty than any other. The fact is, that the subject has been so thoroughly and satisfactorily settled by former writers, that I had little to do but to gather and select the classical problems in the subject, and endeavour to demonstrate them, in my own way. The subject of the Exchanges is that which has been by far the best treated of any in Political Economy, and which is the best understood, from the great and thorough discussions raised in the great currency debates during the war. The fact is, the question was so thoroughly settled then, that there is little probability of the question ever being seriously raised again. Nevertheless, it seemed better to collect the great principles then established, because the time may come again, when they may be useful. The only novel principle that I have added, but it is one of the greatest importance at the present day, is, *that a difference in the rate of discount between any two places, more than sufficient to pay the cost of sending bullion from one to the other, necessarily causes a transmission of bullion from one to the other*, which necessarily shews that the true method of controlling the paper currency, is by a *sedulous attention to the rate of discount*, a principle which was first proved in my Theory and Practice of Banking, and which it is said that the Bank of England have at last learnt and adopted.

The FIFTH Chapter contains a full examination of several theories of Currency of great practical importance,

and it is a wonderful confirmation of the truth of our fundamental conception of the nature of money. It is there shewn that John Law's theory of money is a direct violation of that conception, that it involves a contradiction in terms. Several examples of its adoption and failure are then given. And as we are writing these sheets a terrible confirmation of its truth has just taken place. For American banking is based upon John Law's theory of money. And it is to the erroneous nature of American banking, that the present crisis is owing.

The theory of the Bank of England in 1810, of basing a paper currency upon the discount of mercantile bills, is then investigated, and its necessary consequences demonstrated, corresponding with the actual phenomena. Thus, we see that all parts of the system mutually sustain one another. We then shew the beautiful action of the true regulating power of the currency, namely the rate of discount; how, by its own natural operation, it maintains the equilibrium between production and consumption, always adapting one to the other, and curbing and promoting them in strict accordance with the requirement of nature, so as to prevent violent convulsions.

An historical sketch of the Currency of England is indispensably necessary, and is given in the SIXTH chapter, in which several questions respecting the exchanges are incidentally illustrated.

The SEVENTH chapter treats of the Regulation of a Paper Currency, which is, in fact, the summing up of Political Economy. It exhibits the action of the Bank of England in all the great monetary crises since 1783 up to the present month of November, 1857, and a statement is given of the different opinions that have prevailed. And an account is given of Sir Robert Peel's THREE states of opinion on the currency question. It is clearly shewn

that his opinions in 1844 were entirely different from those he held, and repeatedly expressed from 1819 to 1833. The Bank Act of 1844 is then explained in detail. Such an extraordinary exposure scarcely ever took place. It is proved to be founded upon contradictory principles, and seeks to attain an object which has been repeatedly condemned by all the great authorities of former times, and by all experience. What its fate will be remains to be seen. Thus, it appears that all the great questions in Political Economy flow directly from the doctrine of Exchange.

This work restores the great line of orthodox opinion, so rudely broken of recent years. It is the lineal representative of the ideas of BURKE, of KING, of THORNTON, of HORNER, of HUSKISSON, of the BULLION REPORT, of the FRAMERS OF THE ACT OF 1819. The Currency Question is the most important subject of the day. But it is now in the Arian phase of its existence. Like the throes of Enceladus, it will periodically convulse the world, until it is settled on true scientific principles. That this work is subversive of the dominant opinions of the day is true; but

γνώμαι πλέον κρατοῦσιν ἢ σθένος χειρῶν

Ideas are no respecters of persons. They will sap the power of rank, of wealth, of number, and of authority. Firmly relying on the invincible power of truth, from however humble an origin it may spring, to win its way to universal empire, I submit these pages to the candour and the intelligence of the world.

H. D. MACLEOD.

KENSINGTON,

November 25, 1857.

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PRELIMINARY OBSERVATIONS.

**ON THE NATURE AND LIMITS OF THE SCIENCE OF POLITICAL
ECONOMY.**

ELEMENTS OF POLITICAL ECONOMY.

ON THE NATURE AND LIMITS OF THE SCIENCE
OF POLITICAL ECONOMY.

1. The first thing to be done in the study of any science, is to endeavour to form a proper conception of its nature and limits; then to examine it in its whole extent up to those limits, and to refrain rigidly from all discussions and enquiries which transgress them. In many sciences this is no easy task, but in none is it so difficult as Political Economy. In no science have eminent writers taken so different and various views of its nature and extent; have differed so much as to what should be included in it, or have so varied in their treatment of it. There is nothing in the name of the science which would appear to mark out its precise limits. Seeing, then, that almost every writer differs upon the subject, we think that the best way will be to give a very short sketch of its origin, the views taken of its proper scope by some of the chief writers, and the reasons which have led us to adopt the limits we have done in the following work.

2. The origin of the true science of Political Economy is to be dated from the period of the overthrow of the doctrine of the Balance of Trade, which is due to QUESNAY and his school. What astrology is to astronomy, what alchemy is to chemistry, that was the system of absurdity

and folly which was the established opinion of mankind, and of the most eminent statesmen before the days of Quesnay, to Political Economy. Its establishment was chiefly due to Charles V. and Sully, and for upwards of two hundred years it enthralled the most eminent men. This doctrine was that money was the only wealth, that what one nation gained all the others must necessarily lose, and that every effort should be made by legislation and war to obtain money, and nothing but money. This horrible doctrine, that every nation was interested in, and benefited by, the destruction of its neighbours, was the prevailing belief for upwards of two centuries, and was the fruitful parent of innumerable bloody wars, and incalculable misery and ruin. The ludicrous and palpable fallacy which deceived for so long a period the most consummate statesmen of their day, may well strike us with amazement and humiliation at the feebleness of human wisdom. In pursuance of this imaginary phantom, the earth has been deluged with blood, and nations have everywhere been brought down from prosperity to ruin. It would be well if the recording angel could blot out from the pages of history, such a sickening monument of crime and folly.

3. It is true that during this period a few sagacious men perceived the gross fallacy of the whole system, but they were solitary lights shining in darkness, and the darkness comprehended them not. Their isolated efforts were unheeded and forgotten, and it was not until a powerful sect arose that any permanent effect was produced upon the opinions of mankind. And that honor is unquestionably due to Quesnay and his followers. These men first proclaimed the doctrine that every nation is interested in the prosperity of its neighbours, and not in their destruction, with a power and an authority, which has gone on increasing from their day to this, and having been developed by a long series of illustrious writers, has produced an entire revolution in the opinions of mankind, and in the policy of the most enlightened nations.

4. Although, as we have said, there were several very good works on particular points in the science which is now called Political Economy, it took its rise as a science in the middle of the last century in France. That country had been brought to the lowest state of depression and misery by the ruinous wars of Louis XIV. the financial catastrophe of the Mississippi scheme, the destructive effects of the prevailing mercantile system, the oppression of the nobility, and the weight of the taxes. The terrible picture of social tyranny, cruelty, and oppression which the French people groaned under during the first half of the 18th century, may be seen in contemporary writers. It was in brooding over the intolerable misery under which their country groaned, that a few generous and righteous philosophers struck out the idea that there must be some natural science, some principles of eternal truth with regard to the social relations of mankind, the violations of which were the causes of that hideous misery they saw in their native land. Quesnay, the great father of this science, gave it the name of *Natural Right*, and his object was to discover and lay down an abstract science of the natural rights of men in all their social relations. And this science comprehended their relations towards the government, towards each other, and towards *property*. The term *politique* in French might have in a certain way expressed this science, but that word is so exclusively appropriated to the art of government, that Quesnay adopted the term POLITICAL ECONOMY for this new science. One of his followers, Dupont de Nemours, proposed the name of PHYSIOCRATIE, or the government of the nature of things, but the word having been appropriated to certain doctrines of the sect, which are now shewn to be erroneous, has fallen into disuse, and the term Political Economy has survived.

5. The Science, then, of Political Economy, as conceived by its founders, embraced the whole field of the social relations of mankind, in all their departments, physical and moral. "Right is misunderstood," says Quesnay,

"chiefly because no one, statesman, priest, or philosopher, has placed it in a proper light." His aim and object, then, was to supply this deficiency in philosophy, and to discover the laws of Order, and these related to liberty, property, and authority, the three essential elements in all social organization. His first publication, *Le Droit Naturel*, contains a general inquiry into the nature of these natural rights, and he afterwards, in another called "*Maximes générales du Gouvernement économique d'un Royaume agricole*," endeavours to lay down, in a series of thirty maxims, or fundamental general principles, the whole basis of the Economy of Society. The 23rd of these declares that a nation suffers no loss by trading with foreigners. The 24th declares the fallacy of the doctrine of the balance of trade. The 25th is this; "*Qu'on maintienne l'entière liberté de commerce; car LA POLICE DU COMMERCE INTERIEUR ET EXTERIEUR LA PLUS SURE, LA PLUS EXACTE, LA PLUS PROFITABLE A LA NATION ET A L'ETAT, CONSISTE DANS LA PLEINE LIBERTE DE LA CONCURRENCE.*"

6. In these three maxims were contained the entire overthrow of the existing system of Political Economy, which Quesnay and his followers developed, and notwithstanding all their errors and shortcomings, are unquestionably entitled to be considered as the true founders of the Science of Political Economy. From the publication of these doctrines in 1756, a continuous series of eminent men directly emanating from the school of Quesnay, among whom our countryman, Adam Smith, stands one of the most conspicuous, have been engaged in diffusing them. At last, having gradually won their way and convinced nearly all the most eminent men of all countries, and having been subjected to a series of minor experiments, attended with the happiest results, after a lapse of ninety years, they obtained their crowning triumph by the repeal of the corn laws in England in 1846. This event struck the system of Protection with a mortal blow all over the world. No doubt it will die hard, from the strength of the private interests involved in maintaining

it. But its doom is sealed, and another century will probably see it exterminated from Europe.

7. Now, Quesnay is entitled to be considered as the patriarch of modern political economy, because the illustrious line of writers who have achieved this result continued in an unbroken line from that day to this, and acknowledge him as their common instructor. His fundamental dogma was not only a complete revolution in speculative opinion, but it drew with it a complete reversal of national policy throughout the world. And though, no doubt, some of his leading doctrines are erroneous, men are to be judged by what they succeed in, and not by what they fail in. Quesnay is, therefore, entitled to be considered as the Copernicus of Political Economy.

8. The immediate followers of Quesnay in France adopted very much the ideas of their leader as to the extent of the science, and were chiefly occupied in developing and enforcing his views. But a friend and pupil of Quesnay introduced the study of the new science into this country, and gave it a popularity which the abstract and dry discussions of its originators could never have secured for it. Adam Smith does not even call his work one on Political Economy.—he calls it “An Enquiry into the Nature and Causes of the Wealth of Nations.” His own conception of the nature of Political Economy he gives in the introduction to his fourth Book, as follows: “Political Economy considered as a branch of the science of a statesman or legislator, proposes two distinct objects, first to provide a plentiful revenue, or subsistence for the people; or more properly to enable them to provide such a revenue or subsistence for themselves; and secondly to supply the state or commonwealth with a revenue sufficient for the public services. It proposes to enrich both the people and the sovereign.” And this is almost the only passage in which the expression occurs. Our purpose here is not to criticise that work, but to endeavour to ascertain the limits which Adam Smith gave to the subject. His work, then, treats entirely of the origin,

growth, and accumulation of *material wealth*. It treats of the division of labor; the use of money; the wages of labor; the accumulation and employment of capital; of the different progress of opulence in different nations; an explanation of the mercantile system, and an admirable exposure of its folly; of the agricultural system; of colonies; of the public revenues, and their mode of expenditure; of public works and taxes. It is scarcely necessary to say that he was the ardent and enlightened advocate of free trade, and probably did more to advance the cause than all other writers put together.

9. But without entering into any account of how he has treated the subject, we may say that he has confined his inquiries solely and entirely to the accumulation of material wealth. All persons who employ their labour in any way which does not fix and realize itself in some permanent subject, a vendible commodity, which endures after that labour is past, he classes as unproductive labourers, and considers them as quite beyond the limits of his subject, and passes them over. It is evident, however, that this is a very inadequate view to take of the subject. The next most conspicuous work which we have to mention is J. B. Say's *Traité de l'Economie Politique*, published in 1803. He first excluded all questions of Government from Political Economy. He says "On a long temps confondu la *Politique* proprement dite, la science de l'organisation des sociétés, avec l'Economie Politique qui enseigne comment se forment, se distribuent et se consomment les richesses qui satisfont aux besoins des sociétés. Cependant les richesses sont essentiellement indépendantes de l'organisation politique. Sous toutes les formes de gouvernement, un état peut prospérer s'il est bien administré. On a vu des nations s'enrichir sous les monarques absolus; on en a vu se ruiner sous les conseils populaires." He then remarks what confusion the economists and others had been betrayed into, by mixing together the subjects of Politics and Political Economy.

10. The definition he here gives has been very

generally received since his time; and Political Economy is said to be the science which treats of the production, distribution, and consumption of wealth. He most properly separates Political Economy from all questions of Government, as the growth of wealth is altogether independent of political organization, and states might flourish and decay in wealth, under every form of government. This was a great step in advance, but he made further and more important advances. He saw that it was quite impossible to restrain the name of wealth and capital to material, vendible, and enduring commodities only. He saw, for instance, that the education of professional persons such as lawyers, physicians, &c., was veritable capital, which we may call intellectual or mental capital. In this he was undoubtedly correct, and since his day, intellectual capital of all kinds has been properly held to be within the limits of Political Economy. In accordance with the definition he gave of the nature of the science, his work is divided into three parts. The first is on the production of wealth; the second on its distribution; and the third on its consumption. To the latter word, however, he gives an interpretation to which we cannot accede, and under it he enters into dissertations on public expenses, debts, &c. In a larger treatise on the same subject, named the *Cours complet d'Economie Politique*, he adheres to the same general arrangement, but he introduces many more discussions, which appear to us to be somewhat beyond the limits which he has himself prescribed for the subject.

11. The next work which requires to be noticed, is Ricardo's *Principles of Political Economy and Taxation*, which returns to the narrow views of Adam Smith; being wholly occupied with the discussion of the prices and values of commodities and labor, and the effect of taxation upon them. This work is one of extremely limited compass, indeed, it is rather an attempt to arrive at a few abstract principles, than anything else; but from the name of it, Ricardo evidently considered that taxation is beyond the limits of pure Political Economy.

12. Mr Senior considers Political Economy to be the science which treats of the nature, production, and distribution of wealth; and accordingly, while he follows J. B. Say, and includes all intellectual capital in it, he excludes all questions of taxation, government, colonies, &c.

13. It would appear that Mr. John Stuart Mill also agrees, that these questions are beyond the limits of the pure science, as he entitles his work the *Principles of Political Economy, with some of their Applications to Social Philosophy*. He seems to adopt very much the views of J. B. Say, with regard to its proper limits, and his work is professedly much more extensive than if he had confined himself to pure Political Economy.

14. Many of the recent treatises published on the Continent have come back to the original ideas of the subject in all its extensiveness, and aim at being complete dissertations upon all the social relations of men, physical and moral.

15. Seeing, then, the utter confusion of opinion, and inconsistency of conception of the very nature of the subject which prevails among writers, it may be advantageous to give the views of the nature, objects, and limits of the Science, which will be developed in the following work.

OF THE NATURE AND LIMITS OF THE SCIENCE OF POLITICAL ECONOMY AS TREATED IN THIS VOLUME.

16. Of all the denizens of the earth, man seems to be the only one whose individual efforts are unable to supply himself with all the requisites of life and enjoyment. In the earliest stages, and in the rudest forms of society of which we have any knowledge, men seem to have invariably coveted things beyond what they could obtain by their own exertions. Such objects, however, they could not obtain gratuitously from the labor of others, but they

were obliged to give something in return for what they wanted themselves. Moreover, as man advances in civilization, his wants and desires multiply and increase in variety, the wider is the range of objects he desires to procure. The more objects, however, he desires to acquire, the more must he exert himself to produce something, which the producers of those articles which he wants, may accept in return. Consequently, in order to obtain what he himself wants, he must study and observe what others want, and, reciprocally, if others want what he can produce, they must study what he wants, to offer in exchange for it. By these means, society is bound together by all its members being required to study the wants and desires of each other.

17. The wants of society are, therefore, the stimulus to production. Now, when objects have been produced, there are two distinct and opposing fundamental principles regarding the distribution, or appropriation to each member of society of the things he wants, which have been advocated by writers, and adopted in practice. The first of them is where each individual laborer is allowed to have no exclusive right of property in what he has produced, or in the fruits of his own industry, but each of them is supposed to labour for the general benefit of society, and all the produce is thrown into a common stock, and then is divided among all the members according to some compulsory rule, so that all the laborers receive reciprocally some portion of the fruits of each others industry.

18. The second principle is when each laborer is allowed to retain the exclusive right of property in the fruits of his own industry. The labor of each member is prompted solely by his own individual desire to attain something, and he is permitted, in each case in which he wants anything else, to deal separately with the person to whom it belongs, and the respective quantities of each others produce which is given in exchange, is left solely to the private arrangement of the parties.

19. The first of these principles has, with different modifications of detail, found a crowd of admirers. It has been advocated by dreaming philosophers, visionary enthusiasts, selfish rogues, and innocent saints. Repeated endeavours have been made to carry out some scheme of this nature under a great variety of differing conditions. But they have universally been found to fail; having been frequently started with the fairest auspices, they have always ended in misery and disaster. This would seem to prove that there is something radically wrong in principle in them. There are, no doubt, several minute differences of detail among the various schemes, but they all agree in this, that men should be constrained to work in union with others, and that the rewards meted out to the members of society should be awarded by public authority. All these different schemes which have this principle in common, however they may differ in other respects, may be known by the generic name of **SOCIALISM**.

20. This work is entirely founded upon the second of these principles. It totally rejects the first as nothing but a dangerous and delusive fallacy, which is incapable of succeeding—an impracticable folly, which always has, and always will fail. We utterly abhor and repudiate all forms and schemes of Socialism, however mild they may be. The principles of this work are exclusively founded upon the sacred right of private property, upon the indefeasible right of every man to retain the fruits of his own industry, and to exchange them with those of any one else he pleases, in any proportion they may agree upon among themselves. And it is to these exchanges, and to the different proportions in which different things will exchange with one another, that, in our view, the science of Political Economy is properly limited. And, in our opinion, the object of the pure science of Political Economy is to discover the laws which regulate the exchangeable relations of quantities. Now, the exchangeable relations of any quantity with respect to

any other quantity, is termed its **VALUE** with respect to that quantity. And thus, in our view, the true object of the science of Political Economy is to discover the laws which regulate the values of quantities.

21. Having thus determined the nature and limits of the science, we have next to determine what are the objects included in it. Having determined that its duty is to discover the laws which regulate the values of quantities, it follows that all quantities, or objects, that have value, or exchangeable relations, are included in it. In our view, whatever may be bought and sold comes within the dominion of Political Economy. The earliest cultivators of the science began only with material property, which has exchangeable relations. The next advance was made by including all intellectual or mental property, which has value in it, or which may be made the subject of sale. But here the most advanced political economists appear to have stopped. That is to say, they only consider property which has an actual existence at the present time.

22. But if we include in the science of Political Economy *all* quantities which have exchangeable relations, or have value, that is, all quantities that may be bought and sold, this limitation of the subject to property which actually exists is palpably defective. Because, in all civilized societies there is property of an enormous value, which is bought and sold, which has no present existence, which has only a *future* existence, and which is yet the subject of exchange. And this comprehends the whole theory of the *Present Value of Deferred Payments*. Under this comprehensive title is included the theory of the value of landed property, of annuities, of the public funds, and the whole doctrine of **CREDIT**, which is the great stumbling block of political economists. Under this single title is included property of immensely greater value than all other property whatever, and yet it is wholly neglected by political economists. A future payment may be bought and sold, it has a present value quite distinct from the money it will ultimately be paid in, it is

an article of commerce, just exactly like a quarter of corn. The present value of the deferred payments, which are articles of commerce in England, is probably at least eight fold the actual money in the country, and they are separate and independent values from it, just like any other commodities. The present value of all the bills of exchange and promissory notes in Great Britain at this time is not less than £500,000,000, and yet this is treated as nothing by political economists. The actual specie in the country is not supposed to exceed £70,000,000. And such is the proportion which the present value of the deferred payments bears to the actual money.

23. The science of Political Economy, therefore, in our view, treats of and includes all things, of whatever nature they may be, whether actually, or potentially existing, that may be bought and sold. These are, in our view, its proper limits, and its object is to discover and ascertain the laws which regulate their values.

24. The subject of Exchanges is, therefore, in our view, the limit of the pure science of Political Economy. And this seems to be the opinion of several eminent writers, and some have proposed to change the name of it, as not sufficiently indicative of its nature, and have proposed others in substitution. Thus, Archbishop Whately, who it must always be a matter of deep regret did not handle the entire subject, and who it is quite easy to see would have achieved a greater reputation in it than any other writer who has touched it, has proposed to call it CATALACTICS.

25. We shall, however, adhere to the name of Political Economy. There is no great advantage to be gained by changing the name of a science which has once acquired a firm hold in popular usage, even though that name would not perhaps have been the best that might have been selected, if the science were a new creation. There are few sciences which have not received a great extension or alteration of application of what the meaning of their names would suggest. Plato long ago laughed at

the idea of calling the science which treated of the motion of the heavenly bodies geometry, yet geometry has retained its name from that day to this. And so of the names of many other sciences. But while it is to be remarked that the names of most other sciences received a very much more extensive application than their original meaning, that of Political Economy has been greatly restricted and contracted. The better way, then, appears to us to be, not to attempt to alter a generally received name where no adequate advantage is to be gained, but rather to fix and define clearly what is to be included in it.

26. In our view, then, if there were no Exchanges, there could be no science of Political Economy. It is plain there could be no such thing as *value*. Such a division, therefore, of Political Economy into the production, distribution, and consumption of wealth, evidently does not convey an accurate idea of the science. Because wealth may be produced, distributed, and consumed without any Exchanges, and therefore, without the principles of Political Economy coming into operation at all.

27. Thus, we may suppose that a certain quantity of land may be the possession of a certain number of individuals in common, and each should be entitled to a certain share of the entire produce, without any specific appropriation. It is probable that in the olden times, in the Highlands of Scotland, many families might have lived without ever buying or selling a single article in the whole course of their lives. All their food, clothing, arms, &c., were made of the produce of the estate. The house was made of the native fir trees, all the labour was performed by their own dependents. Now, such a state of society may attain a certain degree of wealth, but it would not be a proper subject for Political Economy, for no such idea as *value* could enter their minds.

28. It has been proved by experience, however, that it is necessary to have a certain peculiar state of moral sentiments in a society, to have any such plan as this

by introducing extraneous discussions. On all the subjects of this work it is possible to arrive at absolute truth. But in such questions as Taxation, Poor Laws, the Transmission of Property, Emigration, &c., there is no such possibility. They are in all respects uncertain, variable sciences, very greatly dependent on particular circumstances. It is impossible to arrive at absolute, universal, demonstrative truth in them.

34. From the preceding remarks, it may appear that the science we are about to treat of is insignificant. It has nothing to boast so striking to the imagination as the triumphs of the astronomer or the chemist. But it is not too much to say, that it is more intimately connected with human happiness and well-being than all the other sciences put together. The astronomer's field of fame lies in the cold regions of space. We may be amazed, almost awe-struck with the powers of the human intellect, which, by a few mysterious symbols upon paper, detected the existence and fixed the position of an undiscovered planet. These, truly, are marvellous triumphs. But though the astronomer may dazzle the intellect, in his lone icy grandeur he is far beyond the reach of human sympathy. But the illustrious man who discovered the palpable truth, *that in commerce both sides must gain*, operated a revolution in public opinion and in national policy, which directly affects the happiness of every human being, and has conferred more solid benefits upon mankind than the discoveries of all other sciences put together. Political Economy is essentially of human interest; it performs among sciences what the Roman poet, in those world-famous lines, asserted to be the peculiar function of his countrymen among nations:—

Excudent alii spirantia mollius æra,
Credo quidem; vivos ducent de marmore voltus;
Orabunt causas melius, cœlique meatus
Describent radio, et surgentia sidera dicent;
Tu regere imperio populos, Romane, memento;
Hæ tibi erunt artes; pacisque imponere morem,
Parcere subjectis, et debellare superbos.

If war is the greatest curse of mankind, Political Economy is the most powerful antagonist of war. If tyrannical monopolies in trade are among the greatest social curses, Political Economy is their most effectual destroyer. When its consequences are clearly apprehended, and its doctrines have won their way to universal acceptance, they will go far to convert the world from a slaughterhouse and a shambles, into a garden of plenty and abundance. What a humiliation for the pride of the human intellect to discover, that for six generations men had converted themselves into hands of legal murderers, that the hand of every nation was armed against every other, the most powerful states have been brought to ruin, and misery and desolation visited upon every fireside in Europe, on account of a phrase, on account of an expression which is now irrefragably proved to be the veriest delusion that ever deceived the senses of mankind! But amidst this universal insanity and desolation, the Genius of Political Economy rose with healing on its wings, to minister the only remedy which could restore prosperity and happiness to the world. One unhappy phrase was the pregnant source of all this woe, the magic of another sentence is alone capable of assuaging it. No doubt the progress of sound ideas is slow, centuries perhaps may elapse before they produce their full effect. But they are irrevocably fixed in the opinions of mankind. The laws of Political Economy are now demonstratively settled. It is not mere uncertain caprice that has made England adopt the principles of Free Trade, but scientific truth. The progress may be slow, but it is irreversible. No one dreams that England will ever go back again to her former errors. Practical success and scientific reasoning equally combine to insure the ultimate triumph of these principles. There is no agent so powerful to subdue barbarism, and to humanize mankind, as a sound system of Political Economy. More than all other causes put together it will help to accelerate the period when the roar of the cannon shall be heard no more, and the sabre

shall rust in its scabbard. When it is clearly seen that the interests of all mankind are bound up in peace, and that every nation is interested in the prosperity of its neighbours, and that the misfortunes of one nation are injurious to the interests of every other, then we may hope that war clouds will cease to lower on the horizon :—

Placatumque nitet diffuso lumine cœlum.

CHAPTER I.

**DEFINITIONS AND ILLUSTRATIONS OF THE TERMS
USED IN POLITICAL ECONOMY.**

“Ἐκεῖνος εὐλόγως ἐζήτει τὸ τί ἐστίν. Συλλογίζεσθαι γὰρ ἐζήτει, ἀρχὴ δὲ τῶν συλλογισμῶν τὸ τί ἐστίν.”

“He (Socrates) wished to reason systematically, and therefore he tried to establish Definitions, for Definitions are the basis of systematic reasoning.”

ARISTOT. *Metaph.* xii. 4.

“Every man, who aspires to true knowledge, should examine the definitions of former authors, and either correct them, or make them anew.”

HOBBS. *Leviathan*.

“Definitiones enim, et partitiones, et horum luminibus utens oratio, tum similitudines, dissimilitudinesque, et earum tenuis et acuta distinctio, fidentium est hominum, illa vera et firma et certa esse quae tutantur.”

“For definitions and divisions, and a discourse which employs these ornaments, and also similarities and dissimilarities, and the subtle and fine-drawn distinctions between them, belong to men who are confident that those arguments which they are upholding, are true and firm, and certain.”

CICERO, *Academic Questions*, Lib. ii. 14.

“The mixture of those things by speech, which are by nature divided, is the mother of all error.”

HOOVER.

CHAPTER I.

DEFINITIONS AND ILLUSTRATIONS OF THE TERMS
USED IN POLITICAL ECONOMY.

OF EXCHANGEABLE VALUE—DIMINUTION IN VALUE—DEBT—CIRCUMSTANCES OUT OF WHICH THE NECESSITY FOR A CURRENCY ARISES—DEFINITION OF CURRENCY—PLATO AND ARISTOTLE'S DEFINITION OF MONEY REJECTED AS INADEQUATE—DEPRECIATION—DISTINCTION BETWEEN DIMINUTION IN VALUE AND DEPRECIATION—SECURITIES FOR MONEY—CIRCULATION—EXCHANGE AND SALE—CIRCULATING MEDIUM—DIFFERENT SPECIES OF CURRENCY—CONVERTIBLE SECURITIES—BILLS OF LADING—DOCK WARRANTS—POSITIVE VALUES—NEGATIVE VALUES—RESOURCES—CAPITAL—FIXED CAPITAL—FLOATING CAPITAL—INTEREST—CREDIT—MONEY—MEASURE OF VALUE—PROFIT—DISCOUNT—WAGES—RENT—HIRE—PRODUCTION AND CONSUMPTION—SUPPLY AND DEMAND—PRESENT VALUE OF DEFERRED PAYMENTS—CERTAIN PRELIMINARY PROPOSITIONS.

1. As soon as men began to render each other services, they must have estimated how much of one kind of service should be given as an equivalent for another. The most natural measure which would suggest itself to their minds, would be the quantity of labor which each had bestowed upon the service he was able to render. The hunter would consider what was the average produce of a day's chase, and he would soon learn what amount of his produce ought to be considered as a fair equivalent for a certain amount of the produce of the herdsman, or the tiller of the ground. Different productions would by this means acquire certain fixed proportions in which they would exchange for each other, and this would constitute their EXCHANGEABLE VALUE, and would remain pretty uniform as long as the same amount of labor continued to produce equal quantities of each of them.

2. If animals of the chase became unusually abundant, so that the hunter could obtain an increased quantity of his produce with no greater labor than before, while the fruits of the field and the fold remained the same, the shepherd and the farmer would be no longer content to receive the same amount of the hunter's produce in exchange for the same quantity of their own. In proportion as it was obtained with greater facility, they would demand more of it; and the exchangeable values of these productions, or the respective quantities of each of them which were considered as equivalents, would undergo an alteration. The produce of the hunter would be said to be **DIMINISHED IN VALUE**, because any quantity of it would exchange for a less quantity of any other production than formerly.

3. In order to make the preceding suppositions correct, it is evidently assumed that all the productions of these several persons were equally desirable or necessary, equally useful or agreeable. But, if any one of these productions had any intrinsic qualities of a peculiar nature, which rendered it more agreeable, or more useful than the others, it would be sought after with more eagerness, and persons would be willing to give a greater proportionate amount of their productions than would be due to the simple consideration of the labour of obtaining them, on the ground of *preference* of one production over another. Thus, if venison were more savory than mutton, there would be a greater demand for it than for mutton, and just in proportion as it was more sought after, the hunter would demand a greater amount of other production in exchange for it. Thus, its exchangeable value would rise. On the other hand, if nobody cared for mutton, the shepherd would not be able to induce any one to exchange his productions, and it would have no exchangeable value, however much labor he had bestowed in rearing it. The same thing would be manifestly true of all other productions. Thus, if the skin of one animal was more beautiful or more useful than the skin of another, their

exchangeable value would be greatly influenced by such a peculiar quality, and would thus by no means be determined by the quantity of labor bestowed in producing them.

4. Each laborer would, therefore, very soon discover that the value of his production, or the quantity of other productions which were considered as equivalent for it, would by no means be indicated by the labor he had bestowed upon it, but would chiefly depend upon the necessities or tastes of his neighbours.

5. Now, every laborer naturally tries to obtain the greatest quantity of other productions that he possibly can in exchange for his own. When, therefore, he saw that the production upon which he bestowed his labour fell in exchangeable value, he would change the direction of his labour. He would give up producing what was held in low esteem for what was in high esteem. He would endeavour to produce what would bring him the greatest amount of advantage in return. But the greater number of people laboring to produce the more desirable article, and the greater quantity thereby produced, would inevitably tend to lower its exchangeable value, and the diminished quantity of the less desirable article produced would inevitably tend to raise its exchangeable value. And this would go on until an equilibrium of advantages was produced among the various labourers, so that there would remain no preponderating reason why any of them should change their pursuits.

6. From these considerations we immediately deduce a principle which is of fundamental importance in Political Economy. We see that *it was not the labor which conferred the value, but the value which attracted the labor*. Each man was obliged to think of something his neighbours wanted, and he devoted his labor to produce such an article. But whether his production had value or not purely depended upon his success in judging what they wanted. He could not compel them to give him anything for his produce against their will. They did not

give any quantity of their own productions for his, because he had bestowed labor upon producing it, but he bestowed labor upon producing something, because he thought others would give something for it.

7. Services in general would, therefore, gradually acquire a recognized exchangeable value, which would not undergo any alteration so long as their relative conditions remained the same. Now, if it could happen that whenever one man required the services of another, that other at the same time had need of an equivalent amount of his services in return, such transactions could take place with great facility, and the amount of services rendered on each side being equal, the parties would be in the same relative situation as before. But it would often happen that when one man required the services of his neighbour, that neighbour would not require an equivalent amount of service in return at the same time. If, then, a transaction took place between them with such an unequal result, and the one amount of service was balanced against the other, there would remain over a certain difference, or amount of service due from the first to the second, and this would constitute a DEBT.

8. The second would, however, require at some future time to have this balance of service due to him performed, and the debt discharged. Moreover, for his own security, he would like to have some evidence, or memorial, to prove the debt, and accordingly he might require the debtor to give him some sign, or token, of the fact. If writing had been known in those times, a statement in writing acknowledging the debt, and promising to render the service due, whenever called upon to do so, would be a natural form of such evidence.

9. We may now suppose that the second person has dealings with a third, and requires his services, but that the third has no immediate use for the services of the second, but requires those of the first; now, if these parties were so circumstanced, what could be more natural than for the second to transfer to the third, the debt due to

him from the first? A similar operation might be repeated by several different parties an indefinite number of times, and so this written obligation, or this evidence of a debt, enabling the possessor of it to demand some service to be rendered by the debtor, would pass from hand to hand, or be current, and from this use of it, the thing itself would be what is called a CURRENCY.

10. This currency is nothing more than the evidence of services having been rendered, for which an equivalent has not been received, but can at any time be demanded. It is obvious that as soon as it has been demanded, and rendered, the evidence of its being due must be given up to the debtor to be destroyed, and will be no longer current. Now, if any man can render services to his neighbours, he must, in return, receive either services or the evidence of their being due, and if he renders more than he immediately requires in return, he will accumulate a store of this evidence for his future wants.

11. It is evident that such a written obligation as has been described, derives its whole transferable or current value from the fact, that the person who acknowledges himself bound to perform such services, can render them at any moment that he may be called upon, and is generally believed to be able to do so. Thus, though it receives its *name* of currency from its being passed from hand to hand, it only is current because it has the power of transferring or circulating something else.

12. These simple considerations at once shew the nature of a *currency*. It is the evidence of a debt due to the possessor of it, proving that he has rendered services for which he has received no equivalent, but which he can demand at any time. And when he does demand it, he must give up or extinguish the evidence of the debt. Hence, the use of the currency is to facilitate the transfer of debts from one person to another, and whatever means be adopted for this purpose, whether it be gold, silver, or paper, is a currency.

13. We may, therefore, lay down as our fundamental

conception, that CURRENCY AND TRANSFERABLE DEBT ARE CONVERTIBLE TERMS; whatever represents transferable debt of any description is CURRENCY; and whatever material the currency may consist of, it represents TRANSFERABLE DEBT and nothing else.

14. The preceding considerations suggest to us a principle which will be found to be of fundamental importance in Political Economy, and it will be seen that it is essentially requisite to bear it in mind in all questions relating to monetary science. It is this, WHERE THERE IS NO DEBT, THERE CAN BE NO CURRENCY. We have seen that where the exchanges were equal, there is no debt, and there can be no currency. The debt represented the precise *inequality* of the exchange, and where there is no exchange, the debt must equal in value the service rendered. Hence, it is perfectly clear that the use of currency is to supply the defect of the exchange, or rather in most cases to do away with the necessity for an exchange. Its real use is manifestly to enable commodities to circulate, or move from the possession of one person to another, or to enable one person to render another services, without the necessity of an exchange. Hence THE USE OF A CURRENCY IS NOT TO FACILITATE EXCHANGES, BUT TO ABOLISH EXCHANGES.

15. It is hardly necessary to say, that this is not the conception of the nature of money hitherto established among writers on Political Economy. The idea originated by Plato and Aristotle, and hitherto universally adopted by all writers, both on the continent and in England, is, that money is the "instrument of exchange," or is the "medium of exchange," and this is the name most usually given to it in modern discussions upon the subject. The principal writers on Political Economy consider money as an intermediate merchandize used for the purpose of effecting indirect exchanges. We cannot do better than give the views commonly entertained, to exhibit the contrast with the one we have proposed. Thus, M. Garnier*

* Elements d'Economie Politique. 3rd edit., 1856. p. 14.

observes that direct barter ceases as soon as nations emerge from the infancy of civilization. In civilized countries such cases are very rare, and in most, impossible. Thus, a bookseller who has nothing but books, can but rarely pay his baker, or his shoemaker, with books. A certain peculiar species of merchandize has, therefore, been devised, called money, which the buyers of books give to the bookseller, and which he can give again to those who sell to him. Thus, he says, the barter is complicated by an intermediate exchange. This money, men have agreed to make of silver, and of gold; and in civilized countries, the shoemaker exchanges his shoes for their equivalent in money, for the purpose of again exchanging this money for a hat, it may be. The operations of the hatter are similar, and they may be represented thus:

The shoemaker
first exchanges his *shoes* for *money*,
then exchanges the money for a hat,
which is equivalent to exchanging
the shoes for a hat.

The hatter
first exchanges a *hat* for *money*,
then the money for shoes,
which reduces the operation to an exchange
of a hat for shoes.

16. Such is the view of the matter hitherto universally adopted, and it may, perhaps, seem somewhat captious to reject a conception sanctioned by so great a concurrence of authority. Moreover, allowing that either conception is correct, it may seem to many indifferent which ought to be adopted. We think, however, that a careful consideration of the two proposed conceptions will show that the one we have adopted is manifestly the more rigidly accurate of the two. But the true reason why we reject a conception so long established, is one which has prevailed in many other sciences, and has conclusively shewn which is the true fundamental conception of the science. It is

this, that although the simple phenomena of monetary science may be explained equally well by adopting either conception, yet, when we come to the higher and more complicated phenomena, they are wholly inexplicable, if we adopt the conception of money as the medium of exchange. If there never had been anything but a metallic currency, the older conception would have been sufficient. And such was the case when the conception originated. In modern times, however, an engine of a much more complicated nature has been devised, namely, *Credit* or *Paper Currency*. Now, our reason for rejecting the conception of money which is in general use is, that it is wholly incapable of solving the more intricate and important problems in the paper currency. On the contrary, the whole theory of credit and paper currency can be constructed, and all the phenomena of them explained, by adopting the fundamental conception we have proposed. A very good proof of the correctness of these remarks is, that no writer who has adopted the older conception has ever even attempted to solve the more intricate problems in the theory of paper currency, or even seems to be aware of their existence. The most stupendous calamities have been brought about by founding a paper currency in contradiction to our fundamental conception. And it will be shewn that this conception will give a satisfactory solution of them all.

17. The force of this reasoning will be apparent to any one who considers several analogous cases in other sciences. Thus, the definition of an angle adopted by Euclid serves well enough for the purposes of geometry, but is quite inadequate to those of trigonometry, which is founded on a totally different conception of an angle to the one adopted in geometry. So the fundamental conception of the central position of the earth was capable of explaining many of the simpler phenomena of astronomy, but being inadequate to explain the more complicated ones, it was rejected in favor of the heliocentric one. So also the corpuscular theory of light was super-

seded by the undulatory theory for the very same reason. Exactly a similar course of reasoning compels us to reject the conception of money as being the *medium of exchange*, and to adopt that of its being the *representative of debt*.

18. Adam Smith, who adheres to the older conception, has, on one occasion, accidentally stumbled upon the truth. Thus, he says,* "a guinea may be considered as a bill for a certain quantity of necessaries and conveniences, upon all the tradesmen in the neighbourhood." Instead of saying that it is a bill upon all the tradesmen in the neighbourhood, he should have said that it is a bill upon all the trading portion of the civilized world. He would then have obtained exactly the true conception. But unfortunately, like a rustic who has found a diamond, he did not perceive the value of the truth he had accidentally expressed, and let it escape from his grasp.

19. It is evident that such a currency would only be of any value as long as people agreed to receive it, and believed that the debtor could perform his promise. But if he granted a great many obligations to render services, people would begin to doubt whether he could perform the whole of them. They would probably think how much he could perform of what he had promised, and as this would be the measure of the real value of the promise, it would not be received as current for more than that. In this state, this currency would be said to be **DEPRECIATED** in value. If this went on for any length of time, they might cease to have confidence that he could perform his promise at all, and they would not receive the paper, and consequently it would cease to be a currency.

20. The examples given in the second and last paragraphs will serve to illustrate the difference between two expressions, which, though often used indiscriminately, are essentially distinct, viz., *diminution in value* and *depreciation*. An *alteration in value* of any commodity means

* Wealth of Nations, Vol II. p. 274. Wakefield's Edition.

that the quantity of it which was considered as an equivalent for a certain amount of some other commodity with which it is compared, has undergone a change. *Depreciation* means that it is not really of the value it professes to be. *Alteration in value* of a commodity is always used in reference to some other commodity, with which it is compared; *depreciation*, in reference to itself. Thus, if at any given time, an ounce of gold will exchange for fifteen ounces of silver, and owing to any great and sudden increase of the quantity of silver, while the quantity of gold remains the same, one ounce of gold becomes able to purchase twenty ounces of silver, then silver is said to have sustained a *diminution of value* with respect to gold, or if while silver remained the same, gold became very scarce, so that one ounce of gold would only purchase ten ounces of silver, then gold would be said to have *risen in value* with respect to silver. But if a bank note which professes to be of the value of five sovereigns, will only purchase four sovereigns, it is *depreciated*; or if a guinea, which professes to contain a certain amount or fixed weight of pure gold, does not contain that amount, it is *depreciated*. The expression *diminution in value* is applicable both to commodities and money; the word *depreciation* is more properly restricted to currency; when an analogous change takes place in commodities, it is usually called *deterioration*.

21. This currency would have another inconvenience. In such a written obligation as we have supposed the amount of the debt due would of course be expressed, and it might very often happen that the person who was the owner of the obligation, would not require to have the whole amount of it rendered at one time. If he required only part of it to be rendered, he would have to give up the original obligation, and receive a new one for the remainder. This operation would be both tedious and inconvenient, and the next improvement would be to have a currency which should not only be evidence of the debt, but also be capable of measuring its amount,

so that the *quantity* of the currency should bear some relation to the amount of the debt.

22. If the debtor were to acknowledge his debt on paper of a certain size, it would be very inconvenient in practice to represent half the amount of the debt by cutting the paper in half, and so on in smaller proportions. So that if the material of the currency was paper, he would have to write an acknowledgment for each minute fragment of his debt on a separate piece of paper. This would be both laborious and tedious, and the next improvement would be, to have the currency made of a substance, which might be divided into any number of fragments, and each fragment represent a proportional part of the debt.

23. As soon as this idea was introduced, it would be obvious that the substance used for a currency should possess several qualities. It should be uniform in its texture, and easily divisible into minute fragments, and it should not be subject to decay. Taking the whole of these requisites into consideration, it is manifest that there is no substance which combines these qualifications so well as a *metal* of some description. Metal is uniform in its texture, and it can be divided into any number of fragments, each of which shall be equal in value to another fragment of equal weight, and if required, these fragments can always be reunited, and form a whole again of the aggregate value of all its parts. By this means, if we can establish a relation between the *quantity* of the metal and the *amount* of the debt, then whatever that relation be, or whatever quantity of metal be taken to represent any amount of debt, any fragment of such metal will always represent a proportionate amount of the debt.

24. In adopting a metallic currency, it would be well to regard a quality in the metal selected for the purpose, namely, that it should be the metal of the greatest value. It should be that metal, of which the smallest quantity should be considered as the equivalent for any quantity of any other metal. The exchangeable values of the different metals are settled exactly on the same principles

as the exchangeable values of all other commodities. Men saw that metals were capable of being applied to different useful purposes. They then, of course, became willing to give other objects or services in exchange for them. Those which were most scarce, and most highly prized, acquired the greatest value. The greater the intrinsic value of the metal, the better is it qualified to perform the functions of a currency. All metals are heavy and inconvenient to carry, and if a very abundant one were selected for the purpose, the quantity which would be required to denote even a moderate amount of debt, would be a serious inconvenience. The more rare and valuable the metal, the more portable and convenient would it be, so that a man might carry about with him, as it were, a concentrated essence of power of commanding services. Of all the metals that were first discovered, gold and silver combined these advantages in the greatest degree, and from the earliest antiquity, the most civilized nations appropriated them to that purpose, and they gradually superseded the inferior metals, and other substances used by other nations, and their exchangeable values relatively to each other, as well as to other metals and commodities, was determined.

25. A metallic currency possesses another advantage over the one we described at first, which derived its current value from the belief and confidence of the persons who received it, that the debtor could perform his promise. That confidence would naturally exist only among his own neighbours, and, at most, among a comparatively small number of persons, who had full opportunity of knowing the circumstances of the individual, and if the persons who took it had dealings with foreigners or strangers, who had no knowledge of the debtor, they would not receive such an obligation. Moreover, the service denoted by such an obligation could only be demanded from the individual who gave it, and people in general would not be willing to give their services, when they could demand services in return from only one person. That person,

too, might die or become insolvent, which might seriously affect the value of his obligations. Now, a metallic currency is free from this objection. Its utility was so evident to all persons who had commercial dealings, that they universally agreed to receive it in return for services. So that when a person receives an obligation expressed by a metallic currency, he is able to command the services not only of the original debtor, but also those of the whole industrial community. It is, in fact, according to the fundamental conception we have established, and, as observed by Adam Smith, a bill upon each person of the trading community.

26. The general consent of the whole nation, or of any number of nations, to receive this metallic currency in return for services, would not in any way alter its nature, nor would it have any value beyond those countries. Consequently it would only perform the same functions as the paper currency, but in a wider circle, and upon an extended principle. Supposing that any nations had peculiar forms of their own, they could not have commercial dealings with each other, except by way of barter, that is, they would have to revert to the interchange of the services themselves instead of their representatives, and would be somewhat similarly circumstanced to persons who could not communicate their ideas to each other, through the medium of any common language.

27. There is clearly, then, no difference in principle between a metallic and a paper currency, only one depends upon a *wider basis of credit, or of acceptance*, than the other. A metallic currency is subject to its own peculiar disadvantages, because by its constant wear and tear as it passes from hand to hand, it suffers considerably by abrasion, not to mention any bad practices that may be resorted to, to lessen its weight, and as we have seen that the quantity or weight of the metal represents the amount of the service the owner can command, as the metal decreases in weight, so does the amount of service

it represents, gradually and correspondingly diminish. Paper is not subject to this intrinsic depreciation, so that if it were possible to have a paper currency based upon the same credit, and which should be as generally received as a metallic one, it would be a preferable form.

28. The paper currency we have described, would in its simplest form have the particular service, or production, it was intended to command, stated on the face of it. This, however, would manifestly limit its utility, so by universal consent, it is almost invariably usual to make the paper currency of a country represent a certain portion of the metallic currency, which is the generally received power of commanding all services and commodities. Paper currency, therefore, in modern practice, instead of promising that the debtor will render any amount of particular service, almost always expresses that he will give a certain amount of metallic currency, either on demand, or at some fixed time.

29. As an example of the species of currency described in the opening paragraphs, we may take the case of postage stamps. These are a rude form of currency, for they represent the power of commanding a certain service, and as every one has sometimes the necessity of sending letters by post, these stamps have come into very general use as small change, and are almost as universally received as payment for small sums, as money itself. As another example of this species of currency, it is said that in the Ionian Islands, it is very usual for the farmers to give promissory notes for the delivery of a certain quantity of oil at a given date at a fixed price.*

30. The observations contained in the preceding paragraphs shew that the idea of a "currency" is quite independent of and essentially distinct from that of "money," and that it would be quite possible to have a currency, even though its most useful form, that of money, had never been thought of. If transactions take

* Encyclopædia Britan.: Art. Ionian Islands. 8th Edit.

place between individuals, it is scarcely possible to imagine that there should not be debts, or balances of services due, arising between them, and this is the basis of a currency. But it does not necessarily follow that there must be "money." If the method of conducting commerce by way of money had never been invented, a grocer and a wine merchant might trade with each other. If they had agreed that a bottle of wine and a pound of tea should be considered as equivalents, the grocer might wish to purchase a bottle of wine, and if the wine merchant wanted in return a less amount than a pound of tea, he might let the grocer have the bottle of wine, upon his giving him a promise to pay the remainder of the tea whenever required. And this note might be made transferable, and it might pass through a hundred different hands before the owner of it demanded the actual tea. It would, therefore, be "currency," but it would not be "money," because it has no intrinsic value. The difference between conducting commercial transactions by way of barter, and by means of the invention of money, is that in the former case commodities are considered directly as equivalents, in the latter they proceed upon the tacit assumption of the geometrical axiom that things that are equal to the same thing are equal to each other. Now, money is that third thing which is used as the common measure to which everything else is referred, and the superiority of the latter mode of conducting commerce is so obvious and decided that it has universally superseded the other in civilized countries, and currency has followed this change, and represents this common measure of value, and is often considered to be identical with it, though not correctly.

31. In the preceding paragraphs we have endeavoured to describe the circumstances out of which the necessity for a currency arises, and its advantages and uses, and to arrive at a definition which may serve as a criterion to decide what is, and what is not to be included under the title of currency. We have also endeavoured to trace

the successive steps in generality it assumed, from its simplest and most inartificial form, when it represented only a particular service, which could be demanded from a single individual, and available in a very small circle of persons, till it finally became a general power of the person who held it, to demand any description of service from the whole industrial community.

32. In giving this description of the nature and uses of a currency, we hope we shall not be so far mistaken as to be supposed to allege that these were the actual steps in its progress. It is a trite remark that practice has always preceded theory. Indeed, the remark is a truism; from the very meaning of the words, it must be so. For a theorist is a looker on, (*θεωρητής*) a spectator, who looks on upon something he sees actually occurring, and tries to discover the reason of what he sees, or the laws of the phenomena. Every person who tries to give a reason for what he sees is a theorist; the only difference lies between a good theory and a bad one. But he must see something before he can try to give a reason for it, or to investigate its laws. Thus, language was universally used many thousand years before grammar, or the theory of language, was thought of. It was from studying the practice of reasoning, that Aristotle laid down the theory of reasoning, or logic. The elementary principles of mechanics were discovered after long and laborious reflection upon mechanical phenomena; and so also the true nature and principles of a currency could only be discovered long after the natural instinct of mankind prompted them to make use of one.

33. The metallic currency is termed money, and the paper currency of all sorts is termed **SECURITY FOR MONEY**. These securities for money, or the paper currency, are divided into two general divisions, firstly, *promises* to pay money—called **PROMISSORY NOTES**, and secondly, *orders* to pay money—called **BILLS OF EXCHANGE**. Each of these general divisions, again, is subdivided into several varieties, which will be examined at

full length hereafter. Some descriptions of paper currency are so perfectly secure that they are often treated as money, or cash. Thus, Bank of England notes are usually designated as money, but that only arises from the perfect confidence reposed in the stability and solvency of that institution, and in a work of this sort we must adhere to precise and accurate ideas. Bank notes, then, whatever repute they may enjoy, are still only securities for money, because they contain a promise to pay so much money on demand, and it is only the belief generally entertained that the bank can fulfill this promise if required, that gives them their current value.

34. The name of currency, as we have seen, is given to some substance, which is capable of passing from hand to hand, and denotes the power its owner has of commanding services. Every transfer denotes an operation, because it is evident that in commerce, every transfer of currency necessarily involves also a transfer of some service. The amount of the sum total of all the transfers of the currency which take places, is properly called the CIRCULATION. Hence, a single piece of money may add considerably to the circulation, for every time it is transferred it is an addition to the circulation, though it is no increase of the currency. We must observe, that this is not the meaning usually affixed to the word "circulation." It is generally used as synonymous with money and bank notes, and more particularly the latter. Thus, the number of notes issued by the Bank of England, or any other bank, is frequently called its circulation. Of all the terms in common use, this is one of the most objectionable. To call the notes which circulate, the *circulation*, seems as great a confusion of idea, as to call a wheel a *rotation*. We shall accordingly never use the word circulation to mean the amount of the issues of a bank, the more correct expression is evidently to say, the number of its *notes in circulation*. We shall always use the words currency and circulation to mean different things, the first to denote the substance itself, the

second the amount of its transferences from hand to hand. It is also clear that the currency and the circulation do not bear any fixed relation to each other, for there may be a large amount of currency in a country, yet if the industrial operations be few, there will be a small circulation; on the other hand there may be a small amount of currency, yet if the people be active and industrious, it will pass frequently from hand to hand, and there will be a large circulation.

35. The use of the currency being to record and transfer debts, if we could imagine a great Public Book kept by the national authority, in which every one was entitled to enter his services, which should be valued at a certain amount in figures, it would present the most perfect idea of a currency. For any one who had credit in that book, might require the services of another person, and give an order to the national bookkeeper to transfer the figures, denoting their amount, from his own to his creditor's column. The book itself would be the record of the evidence of the debts, the total amount of the figures at the credit of each person would be the total amount of the currency in the country, and the transference of the figures from one column to another, would be the transference of the debt, and would denote an operation just as the transference of money from one person to another, and the amount of these transferences would be the circulation.

36. Gold and silver being useful for other purposes besides serving for a currency, have a certain intrinsic value, and for that reason alone, they are to a certain extent, wealth in themselves. Being used as the measure of wealth, and the value of all commodities and services being expressed as worth so much gold or silver, many persons who were unable to discriminate the simple ideas involved in a complex one, have been led to entertain very erroneous notions upon the subject, and have considered *money* and *wealth* as convertible terms. Gold and silver, however, derive their chief value from their

peculiar fitness to form a currency, and they are less useful for general purposes than almost any other metal.

37. Currency and commodities are things essentially distinct in their nature. It is often considered that currency *represents* commodities, but such an idea must be carefully guarded against. Currency does not represent commodities, but an abstract right or power of demanding services in general, which may or may not be commodities. Now, transactions between individuals may be an interchange of things of a like or an unlike nature; when the interchange is of things of a like nature, such as currency for currency, or commodities for commodities, it is called an EXCHANGE, or in the case of commodities, frequently BARTER. Thus, we speak of the Foreign Exchanges, or the value of the currency of one country in terms of the currency of another; or we ask for the change (*i. e.* the 'change or exchange) of a £5 note or a sovereign; so we speak of exchanging a picture for a statue, or one book for another. When the interchange is of things of an unlike nature, such as currency for commodities, it is called a SALE, and the one that gives currency is said to BUY the commodity, and he who gives the commodity is said to SELL it. Thus, we buy a horse or a house with money, so an officer *buys* a commission in the army, but he *exchanges* from one regiment to another; so, in *Lear*, when Albany throws down his glove to the traitor Edmund, the latter throwing down his own replies, "There's my exchange," meaning like for like; so in *Hamlet*, Laertes says,

"Exchange forgiveness with me, noble Hamlet."

The quantity of the currency given for the commodity is called its PRICE, and when the buyer of the goods transfers their stipulated price to the seller, he is said to PAY for them.

38. The subtle question whether, if a fair exchange of goods were substituted for the payment of money, it was to be considered as a sale, was warmly debated for

150 years by the two famous sects of Roman lawyers, the Proculians and the Sabinians, from the time of Augustus to that of Hadrian. Both parties appealed to Homer in support of their views, but the opinion of Proculus finally prevailed, that a *sale* and an *exchange* were operations essentially distinct in their nature. This was confirmed by the Emperors Diocletian and Maximian, and was ratified by Justinian.* The conclusion was just, though the reason assigned for it is scarcely satisfactory, that "in the exchange of two things, it can never appear which has been sold and which has been given as the price of the thing sold, and it is contrary to reason that each should appear to have been sold, and that each should appear to have been given as the price of the other." It would rather appear that when we exchange one commodity for another, we exchange one whose useful qualities are known, for another whose useful qualities are also known; that is, we exchange two things which are acknowledged to be equivalents. But the currency represents an abstract quality or right. In changing a commodity for currency we commute a known useful quality for an abstract right; that is, we give a commodity and receive in return only the power of obtaining an equivalent; or we exchange something that is definite for another that is indefinite, two operations which are essentially distinct, and it is better to appropriate different expressions to operations of a different nature.

39. We must carefully observe that the word CURRENCY is a complex term, involving two simple ideas, and we must resolve it into them. From its first representing a debt, its fundamental idea was, that it was something that denoted the power of demanding services, and secondly, it also passed from hand to hand itself. Of these two ideas it must be especially observed that the former is the fundamental idea, but it has received its *name* from

* Institutes, L. III., c. 24.

the latter. Resolved into its elementary ideas it is, therefore,

1. That which *circulates commodities*, i. e., which causes commodities to circulate; where *circulates* is an *active* verb.
2. That which *circulates itself*; where *circulates* is a *neuter* verb.

From the first of these ideas it has acquired a name in modern times significative of its quality, viz., CIRCULATING MEDIUM.

40. We shall find hereafter, that it is of great importance to fix the precise meaning of the term *Circulating Medium*, because a misconception of its true meaning has had several very important consequences in Political Economy. What these are, we shall defer saying, till a future part of this work. We shall simply say at present, that the meaning universally given to the term Circulating Medium, at the time it originated, was the medium that circulated commodities. In recent times it has been used to signify the medium which circulates itself, which is quite erroneous. As, however, we wish to avoid controversy as much as possible at present, we shall defer a full examination of this question till a future chapter.

41. The amount of the currency, or circulating medium, in any country, is the aggregate amount of it belonging to every individual. Now, whatever represents the amount of debt due to any individual over and above his possessions in commodities, in whatever form that debt be recorded, whether metal or paper, or whether it exists simply as a debt, is the amount of currency belonging to him. Whatever, therefore, confers the power of demanding services or commodities, or professes to confer the power of demanding them, is the currency or circulating medium of any single person; and includes not only the current coin of the realm, but all its substitutes of every description, and whatever else represents or displaces it. Adopting this definition, we may enumerate the different species of it as follows:

1. Coined money; gold, silver, and copper.
2. The paper currency,—including promissory notes and bills of exchange, with all their varieties.
3. Simple debts of all sorts; such as balances at bankers, book debts of traders, and private debts between individuals.

42. Balances at bankers are clearly a portion of the currency, or circulating medium, because the figures represent sovereigns, and the creditor can demand sovereigns for them, or he can convert them at any moment into a cheque, which is a Bill of Exchange payable to bearer on demand, and it is in all respects equivalent to a bank note, and is capable of performing the same functions. That the sum standing at a customer's credit in his banker's books is to be considered as money has been decided in Chancery.* Nor can a debt due from a private person be treated on any different principle, because it can be converted into a Bill of Exchange at any moment, at the pleasure of the parties.

43. It is certainly true that some of these descriptions of currency are more eligible and secure than others, but they are all of the same nature, and perform the same duties, with different degrees of advantage. The metallic currency rests upon its own intrinsic value, the credit of the state, that it is of the proper weight and fineness, and the universal readiness of people to receive it in return for services. Paper currency, in this country at least, rests entirely upon private credit, and is of all possible degrees of security, from a Bank of England note down to a gambler's I.O.U. There are several different kinds of paper currency possessing more or less of a circulating power. But yet all these different descriptions of currency, though more or less eligible and secure, represent but one fundamental idea—*debt*. From these considerations, it follows that the amount of the currency or circu-

* *Manning v. Purcell*, 23 L. J. Chanc. 423.

lating medium in any country is *the sum total of all the debts due to every individual in it.*

44. It might be objected, perhaps, to the opinion that a private debt is to be considered as currency, that it is what is called in English law a *chose in action*, or mere right of action, and is not assignable at common law. The reply to such an objection is, that the non-transferability of debt is a local peculiarity of English law. It was merely devised on account of certain arbitrary ideas of public policy, and is not to be considered when we are treating of things according to their natural qualities. The most perfect freedom in the assignment or transference of private debts is the very foundation and life-blood of modern commerce. This is effected by means of Paper Currency, and the whole system of Bills of Exchange, Promissory Notes, and Cheques, is a direct violation of the common law of England, and they were so regarded when they made their first appearance in Westminster Hall. The fundamental principle of modern commerce, and that which has given it such an immense extension is, that a debt is treated in all respects as a saleable commodity. It is considered as a species of merchandize, just like money. In dealing, therefore, with the general principles of the subject, we must consider the non-assignability of debts in England as a mere local caprice which does not affect the nature of the thing.

45. The extreme impediment to trade caused by the obstructions placed by the common law on the transference of private debts, was clearly seen by Sir Josiah Child, in the 17th century, who has a chapter on the subject, in his Discourse on Trade; and he even went so far as to wish not to leave it optional to the vendor and purchaser, in the case of the non-payment of ready money, to leave the debt in a verbal state, but he proposes that it be enacted that every person whatever, who bought goods, and did not pay ready money for them, should be compelled immediately to give a bill, under his hand and seal, for the amount, with the time of

payment agreed upon, which should be as transferable as money.* Sir Josiah thus hit upon the true idea of a currency. In a future chapter we shall see that the business of banking chiefly consists of buying and selling debts.

46. Mr. Henry Thornton, the author of the *Inquiry into the Nature and Effects of Paper Credit*, seems to have been the first to perceive that balances in the bank, were to be considered as part of the currency of the country. In his evidence before the committee of secrecy of the House of Commons, in 1797, on the occasion of the bank restriction, he says, (p. 94) "balances at the bank are to be considered very much in the same light, with the paper circulation." In recent times, however, a different opinion has prevailed, which we shall discuss hereafter.

47. We shall, therefore, use the terms "currency," and "circulating medium," in this work, as absolutely identical, and co-extensive, the latter being founded upon its fundamental conception of circulating commodities, the former on that of circulating itself. It is true that the former is considerably the older term, and is derived from that portion of the circulating medium, which was most frequently thought of. Some persons, too, might be a little startled at first, at seeing such an extension given to the word "currency." But it is merely an instance of what has repeatedly happened in other sciences, that names have been given to substances from some particular quality in them, which first attracted attention, and it has been afterwards discovered that that was not their fundamental idea, and the class has been extended, through the exigences of science, to include other things which have no trace of the quality, whence it derives its name. We may mention as familiar instances, two cases in geology, and chemistry. In geology the term "oolite," was first applied to rocks, which resembled the roe of a fish, but the necessities of science compelled geologists

* *A New Discourse of Trade*, p. 126. Edit. 1698.

to class certain other formations, which have no resemblance to roe, under the term of oolite, and such classification is universally adopted. So also "white chalk may be yellow, green, or black, and is actually of these colors in some places, but notwithstanding these stains upon its character, it is still called "white" by courtesy.* So the term "combustion" was applied to certain phenomena in chemistry, on account of heat being developed during the process. But a deeper knowledge in chemistry disclosed that it was merely the process of oxygen combining with some other substance, and the quality of the evolution of heat was accidental, and that there are cases of the combination of oxygen with substances where no heat is developed. And yet these are classed under the term combustion. Thus, the rusting of iron is merely the process of oxygen combining with it chemically, and is classed as combustion, though no heat is developed. So the word acid has received an extension which includes many things which are not *sour*. To say, then, that private debts are to be classed under the term currency, can be no stumbling-block for an instant, to any one who considers these analogous cases. It is merely an example of what has repeatedly happened in other sciences, when more correct views were entertained of the proper classification of their objects.

48. It would be quite easy to multiply instances of a similar necessity which have occurred in many other sciences, but the ones we have given are sufficient for the purpose. "Descriptive names," says Dr. Whewell,† "although they might be supposed to be the best, have, in fact, rarely been fortunate. The reason of this is obvious:—the mark which has been selected for description may easily fail to be essential, and the obvious connection of

* Quarterly Review. Vol. xcv., p. 393. See also Whewell's Phil. Ind. Sci. for other examples.

† Hist. of the Inductive Sciences. Vol. iii. p. 433. Edit. 1857.

natural facts may overleap the arbitrary definition. * *
The signification may assist the memory, but must not be allowed to subjugate the faculty of natural classification."

49. It is most particularly to be observed that it is the essential quality of currency, that it is a general charge of debt upon the person of the debtor, or obligant; and is not a title to any specific or particular articles. In all cases whatever, it involves the idea of personal liability. Thus, in Section 30, where the wine merchant is supposed to take the grocer's promise to pay a half pound of tea when required, in return for the wine he lets him have, it must be distinctly remembered, that this is a general power to demand so much tea from him, and is not a particular appropriation of any specific quantity of tea. The whole of the grocer's stock of tea remains his own property until the demand is made upon him for payment. Consequently he can sell or dispose of it all, if he pleases, which he could not do if any particular part was set aside as the property of another person, and he was merely the keeper of it.

50. This distinction is of the utmost importance, and it serves to shew that the transferability from hand to hand is not the fundamental conception of a currency. There are certain commercial documents which bear a resemblance to Bills of Exchange, in respect of their being transferable from hand to hand, and are supposed to be of the same nature. These are Dock Warrants, and Bills of Lading. When property is deposited in the Docks, the owner of the Dock grants a receipt for it, and this, for the convenience of commerce, is assignable at will, and whoever is the holder of it is the owner of the property. So, when a ship is loaded for a foreign port, the shipmaster grants receipts for the goods on board of her, and these "Bills of Lading" may be sold fifty times before the actual property is demanded. Both Dock Warrants and Bills of Lading are merely the titles to certain specific goods, warehoused in the dock, or on board ship, and involve no personal liability or debt.

On the other hand, a Bill of Exchange is purely a charge of debt upon some particular person. It is expressly contrary to the fundamental conception of a Bill of Exchange, that it should be an appropriation of any specific funds. If a document purporting to be a Bill of Exchange is a specific appropriation of any particular funds, it immediately ceases to be a Bill of Exchange.

51. The great importance of distinguishing between the fundamental conception of Bills of Exchange, and that of Bills of Lading and Dock Warrants, may probably not be apparent at present; but it will fully appear hereafter. Some most dangerous and fatal ideas on the subject of Credit are founded upon confounding the two things. One thing only we will note at present,—that Bills of Lading and Dock Warrants can never exceed in quantity the property they represent, but that Bills of Exchange greatly exceed the quantity of coin they profess to represent, because they do not represent any particular coin, but they are only an engagement that a person shall have the money at some given time, and it is quite possible that the same coin may discharge a hundred Bills of Exchange in succession.

52. It is of such great importance to fix the preceding classification and distinctions in the mind, that we will illustrate them further by quoting from Dr. Whewell,* a conversation between Linnæus and one of his pupils, Giseke, which presents an exact analogy to the views we are seeking to enforce. Giseke was much puzzled by being unable to see the intelligible grounds upon which Linnæus proceeded in his collection of natural orders. He narrates a conversation which he held with the great teacher, upon the subject which presents the most striking points of similarity with the preceding paragraphs. Giseke began by conceiving that an order *must* have that attribute from which its name is derived, that the *Umbellatæ* must have their flower disposed

* Hist. Ind. Sc., Vol. III., p 270, Edit. 1857.

in an umbel; the mighty master smiled, and told him *not to look at names but at nature.*

"Giseke.—But what is the use of the name if it does not mean what it professes to mean?"

"Linnaeus.—It is of small import what you call the order, if you take a proper series of plants, and give it some name, which is clearly understood to apply to the plants, which you have associated. In such cases as you refer to, I followed the logical rule of borrowing a name *a potiori* from the principal member. Can you give me the character of any single order?"

"Giseke.—Surely the character of the *umbellatæ* is that they have an umbel?"

"Linnaeus.—Good, but there are plants which have an umbel and are not of the *umbellatæ*?"

"Giseke.—I remember; we must, therefore, add that they have two naked seeds."

"Linnaeus.—Then *Echinophora*, which has only one seed, and *Eryngium*, which has not an umbel, will not be *Umbellatæ*, and yet they are of the Order. Both are beyond dispute *Umbellatæ*."

53. Let the reader of this work thoroughly imbibe the spirit of the preceding conversation, and not proceed any further until he masters the idea that we must look beyond names to the nature of the objects we are treating about, for a proper classification of them. Just as there were plants which had no umbel, and yet were of the order *umbellatæ*; so, though private debts are not current, yet still they are *currency*; and as there were plants which had umbels, and yet were not of the order *umbellatæ*; so also dock warrants and bills of lading, although they are current, are yet *not* currency.

54. The definition we have established of the nature of a currency, furnishes us with a criterion to decide whether certain things are currency which may appear at first sight to be so, or at least to bear a close affinity to it. We may take Government Stock, or the Public Funds, as the representation of the class, which includes Bank, Insurance, Railway, Dock, and other shares, and all that class of securities which appear on the

face of them to represent money. Many persons have made their wills, intending to bequeath their property in the Funds in a particular manner under the title of *money*. But the Courts of Law have uniformly rejected that interpretation, and held that Stock is not included in the title of money, though they expressed their regret at being obliged to do so, as they did not doubt that if the testator could have explained his intentions, he would have said that he meant to indicate stock by the word money. Is, then, Government Stock, and the class of securities of which it is the type, currency? The answer is that they are clearly *not* currency. A Railway Share does not represent money, but it is a certificate that the owner of it has paid a certain price for the purchase of a certain portion or share of the railway. The value of that share is estimated by the profits it is expected to produce. This share, then, does not represent currency, but an interest in property, the value of which is variable, and rises or falls according as the profits of it are greater or less. Similarly, Bank, Insurance, and other shares represent a certain interest in the property of these concerns; these shares are, therefore, to be placed in the same category as title deeds to property, and are not to be considered as money, or currency. And Government Stock is exactly of the same nature. The Public Funds are an estate or property, producing a certain known revenue, guaranteed by the public faith, and what goes by the name of Stock, is a certificate that the owner of it is the possessor of a certain amount of this estate or property, and the value of this property varies according to the profits derivable from other investments, and from time to time either exceeds or falls short of the price originally paid for it.

55. On the other hand, a Bill of Exchange or a Bank Note, professes to represent a fixed sum of money, and nothing else, and the holder of such a security does not expect to receive more or less money for it than is stated

on the face of it. But the holder of stock and other similar securities, hopes or fears to receive either more or less than he gave for them, according to a multitude of causes that affect their value.

56. There are two expressions which are very apt to be confounded, but which are very distinct in their nature, viz., *Securities for money*, and *Convertible Securities*. The former mean securities for the payment of a definite sum of money at some given time, the latter are merely title deeds, or certificates of property. Securities for money, by the considerations we have established, are currency; convertible securities are not currency, but property. Securities for money comprehend all obligations to pay money, such as Bills of Exchange, Promissory Notes, Cheques, Bank Notes, Exchequer Bills, Navy Bills, &c., &c. Convertible securities include Bills of Lading, Dock Warrants, the public funds, shares in all sorts of companies, and all title deeds to property of a moveable description, the property of which passes by simple delivery, and at a short notice. Convertible securities mean those securities which can be converted into money at a short notice, or for which a purchaser can readily be found. The difference between the paper currency, or *securities for money*, and *convertible securities* is, that one represents merely promises to pay something, but the others are the titles to the actual property itself; a distinction of the utmost importance, because promises to pay money may be, and are, multiplied far beyond the actual quantity of money, which is the system of credit; in the latter case, by the very nature of it, the titles can never exceed the actual quantity of property in existence. We may state it thus,

Securities for money *never* represent any specific money, but *always* a claim on the person.

Convertible securities *always* represent some specific goods, and are *never* a claim on the person.

57. A variation in the price of securities for money, such as Bank Notes, &c., and convertible securities, such

as the Funds, &c., clearly illustrates the distinction between the term *depreciation* and *diminution in value*. A Bank note professes to represent a fixed sum of money, and if it will not purchase that amount it is *depreciated*. On the other hand, the value of Stock, &c., is known to be variable, and if it sells for less than was paid for it, it is *diminished in value*.

58. The simplest and most perfect form of a currency is that which represents nothing but transferable debt, and of which the material is of no intrinsic value, such as paper. It is only, however, when States have reached a high degree of civilization that they adopt this perfect form. Before they attain that, the material of it entirely consists of something which has an intrinsic value, such as Gold or Silver. From this circumstance, the purchase of an article with a gold coin is of a mixed character, and partakes somewhat of the nature, both of a barter, and of a sale. But this intrinsic value is a secondary circumstance, and not the one which gives it its characteristic as a currency. It is its general reception as the visible symbol of transferable power, which is also called negotiability, which is the essence of a currency, and distinguishes a coin from a medal.

59. In speaking of the word VALUE, writers on Political Economy are frequently in the habit of considering it as the *quality* which renders objects sought after. But this is clearly an error. Political Economy has nothing to do with the reasons why people are led to desire certain objects rather than others. That belongs to a different science altogether. Political Economy has no more to do with the reason *why* people desire certain things, than Astronomy has to do with the metaphysical cause of gravity. All it has to do is to accept the fact, and trace its consequences. To apply the name of Value to the qualities which render any object desired, is an example of the common fallacy of giving the same name to the phenomenon, and to the cause of the phenomenon, which has

been well reprehended by Mr. Mill.* In the present science we must rigidly limit ourselves to the fact that persons do actually desire certain objects, and that they will give other objects, as well as their own labor, to obtain possession of them, and the quantity of these objects which they will give for any other object, is termed the Value of that object in respect of the others. By the word Value, then, we mean nothing but the exchangeable relation of objects with respect to their numerical quantities.

60. From this error of considering value to express the quality which makes an object desired, Adam Smith has adopted from Turgot, a distinction which is most unphilosophical, namely, *Value in use* and *Value in exchange*. Thus, he remarks, as John Law had done before him, that water has a great *value in use* but none in exchange, and a diamond has a great *value in exchange* but none in use. This distinction has been admitted by most succeeding writers, but it is extremely detrimental to the true conception of the subject, and must be carefully guarded against. We must entirely discard all reference to the use of things in speaking of their *Value*. When it is said that water has *no* value in exchange, it is merely an example of the mathematical symbol 0. It coincides exactly with the popular use of the word *nothing*, which does not mean an absolute positive nothing, but something so infinitesimally small, as to be beyond conception, but which may be developed under certain circumstances. It has the germ or trace of value. There are circumstances in which a glass of water may fetch a very high price, as at the coronation, and similar cases. In all towns where water-rates are paid, every drop of water which is used manifestly costs something, although it is inappreciably small. The distinction, then, is utterly destructive of all philosophical symmetry. Water is merely the lowest term of a series, of which the highest is the diamond.

* System of Logic. Vol. II. p. 424. 4th Edit.

61. Hence, all objects which we require, and for which we would rather give a price than want, but whose quantity is so abundant that we can obtain them for nothing, may be said to have the value 0, as water, air, &c.: among these things many writers place the natural force of the wind. Now, the wind is common to the whole world when it blows. But the wind is capricious; sometimes it does not blow when it is wanted, sometimes it blows in the contrary direction, and in all these cases we go to an expense to obtain a substitute more obedient to our desires. Steam mills are fast superseding wind mills, because the wind is so uncertain, and steam ships are superseding sailing ships. Now, the sum we pay for erecting an intrinsic moving power like steam, shews exactly what the value of the wind is; *i.e.*, what we would be willing to pay for a constant supply of wind; and so on of other similar things. Hence, whatever we require, and would be willing to pay for rather than want, has a value, however small it may be, and is merely the lowest term in the series.

62. The ideas of *labor* and *value* are so intimately connected, that to separate them seems an operation of almost as much nicety as Sir Charles Bell's separation of the nerves of sensation and motion. But it must be carefully done. Labor and value have no necessary relation whatever. It is certainly generally true that most values are the result of great labor, but yet labor is in no case whatever the cause of value. It is the result, and the result alone, which possesses value, whether that result was obtained with much or with little labor. If a man picks up a diamond, that diamond is equally valuable as if he had bestowed twenty years in searching for it. It is not valuable because he picks it up, but he picks it up because it is valuable. One man may expend a great deal more labor or money in producing a given result than another man, but the result is not the least more valuable on that account, and if it is inferior in quality will be less valuable. This will be illustrated at greater length hereafter.

63. Again, all value is purely local. Results produced for which there is no demand have no value, or results removed from places where there is a demand for them, to places where there is no demand for them, lose their value. If a person were to expend a great deal of labor and expense in learning Chinese, such an accomplishment might be very valuable in London or Paris, where there is usually a demand for such acquirements. The possession of this knowledge has a value in such places. But if that person were to go and live in the Hebrides among the cottiers, there could be no possible demand for such knowledge there, and consequently it would have no value. The same reasoning is universally true, the same principle applies to every other result produced. A guinea has great value in most countries in Europe, but removed into the interior of Africa it would have none. A £5 Bank of England note is at present in London in all respects equal to five sovereigns, and while it is received with equal readiness, is of exactly the same value. Removed to a place where people would not receive it, it would lose its value. Among a certain class of people, a Raphael or a Correggio is of inestimable value, others would greatly prefer a fine flaring signboard. In no case, then, is it labor that confers value on a result, but only the demand for it.

64. It is not, then, labor that confers value, but value or demand that attracts labor. Now, it is evident that labor may have value from two entirely opposite reasons. Persons may require services for two opposite reasons. They may spend money either to obtain something they want, or to get rid of something they don't want. Either to purchase an enjoyment, or to get rid of an encumbrance. This distinction is of the most important nature. To the person who is able to render such services it makes no difference, he gains his fortune either way. But to the community at large, the distinction of the nature of these employments is very important. We may denominate those objects which we would pay to obtain, POSITIVE

VALUES, and those which we would pay to get rid of, **NEGATIVE VALUES.**

65. Thus, if I see a book or any other article I desire, and will give something to obtain it, such an article has positive value. On the other hand, I may be burdened with something noxious and injurious to me, and I may be willing to pay to get rid of it. Such a thing has *Negative Value*. In either case the capability of a person to render me this service is of value to him. Thus, if a river or the sea overflows my land, and thereby renders it impossible for me to cultivate it, I pay an engineer to raise an embankment to keep it out, I have too much water, it is a nuisance to me, I pay to get rid of it. It is, therefore, a negative value.

66. Or my land may be covered with rocks, or a forest, or anything else. I must pay money or bestow labor in clearing it. All such things have a negative value. Or if my land is encumbered with old buildings, which must be pulled down, before I can build a new house, I must pay to get rid of them. These things, therefore, have a negative value for me. Therefore, the zero point of value is where my property is in such a position that I may begin to lay out money profitably upon it, as when the ground is cleared for cultivation or building. Benefits, therefore, are positive values, encumbrances are negative values.

67. Now, it is evident that a very large class of professions are solely employed about negative values. Thus, when I am encumbered with disease I employ a doctor to get rid of it. When I am oppressed with injustice, I employ a lawyer to obtain redress. When I am in fear of being oppressed by violence, foreign or domestic, I pay soldiers or policemen to defend me; and as mankind are weighed down with evil and sin, they pay clergymen to aid them in getting rid of it. All these are negative values, and all the money spent by men for these purposes, is only to restore them to the position they ought to have been in, without their assistance.

68. Now, it is quite clear that we cannot begin to make profit of anything until its negative value is got rid of. Hence, all negative values are subtractions from national wealth. All the money spent upon negative values is only to remove obstructions to the progress of wealth, and it is quite clear that if the cause of those negative values or encumbrances could be removed, the money and industry spent upon them might be employed in positive values. Remove the causes of disease, and the money spent upon doctors, and the doctors themselves, might be employed upon positive values. If my land were not overrun with the forest, or encumbered with old buildings, or deluged by the sea, the money spent upon removing those obstacles might evidently be devoted to develop its fertility, or in other employments of a positive value. The quantity of money or labor necessary to expend, to put it into a condition to be profitable, is its negative value. And when anything is in this state, it is evidently necessary that it should produce double profits to the extent of its negative value, in order to render it worth doing.

69. Hence, all employments may be divided into those based upon positive values, and those based upon negative values. And though to individuals themselves each of these employments may be equally useful and profitable, yet it is always a good sign in a state when the number of persons employed on positive values increases, and that of those employed in negative values decreases.

70. The RESOURCES of a country are all those objects which taken by themselves are not wealth, but which are capable of being applied to the production of wealth. They comprehend in the first place the object upon which industry may be usefully employed, such as a fertile soil, minerals, forests, fisheries, &c., secondly the fund of industry, skill, and talent which may be employed upon them; and, thirdly, the power which puts industry in motion, which is currency. Neither of these three taken

singly can be of any use. But a judicious combination of the whole produces wealth. We shall always preserve a distinction between wealth and resources; the former being the production which is an end, or an object of desire for its own sake, the latter being the materials or means applicable to such purposes. The currency is more properly to be regarded as one of the resources of the nation rather than part of its actual wealth, because, though industry has been bestowed upon its production, yet its production is rather a means to an end, and not the end itself.

71. As the use of the currency is to set industry in motion, and inasmuch as it has no use except so far as it does that, its beneficial effects are not to be measured by its actual amount, but by the quantity of industry which it generates. Money lying locked up in a box cannot increase of itself, and only represents *latent* power and not actual power. It may be called power, or wealth in the latent state, and resembles the steam engine of a mill which is not going, and is of no use unless it is set in motion, and as the produce of the mill is measured by the quantity of the motion of the engine, so is the useful effect of the currency measured by the quantity of its motion, which we have called the *circulation*. Now, as this circulation, which is the sole test of its useful effect, is the product of its amount multiplied into the velocity of its circulation, it is clear that if by any means we can increase the rapidity of the circulation of the existing currency, it will add greatly to its beneficial power, or if only a certain amount of business can be done, we may diminish the quantity of currency necessary to carry it on by increasing its rapidity of circulation. Engineers usually call the quantity of the motion of the engine its *duty*, so we may call the circulation of the currency its duty.

72. It is so essential to have a clear conception of the useful effect produced by any given amount of currency, that we may add another illustration. The

effect produced by any body in motion is determined, not only by its weight or mass, but also by its velocity, and is called its *momentum*. If the mass be diminished, yet by increasing the velocity, the result or momentum may still be the same. Thus, if a body of 100 pounds weight move with a velocity which we may call 1, its momentum will be 100; now, if we diminish the weight to 50, and can double the velocity, the effect or momentum will still be 100, the same as before. The operation of the currency is precisely analogous to this. Its useful effect is the result of its combined amount and rapidity of circulation, which we have called the CIRCULATION. If we can make £50 circulate with twice the rapidity that £100 did before, the useful effect or circulation will be the same. Thus, the circulation of the currency may be aptly compared to the momentum of a body; hence, we may say that the circulation is the momentum or duty of the Currency.

73. As the useful effect, or the industrial operations promoted by the currency, does not depend solely on its amount, we may see how impossible it is to form any estimate of the wealth of a country by the amount of money, or gold and silver in it. One country may abound in gold and silver, and yet be poor; and another may have comparatively little, and yet be rich. Spain was a country in which, at one time, gold and silver were more plentiful than any other in Europe, and yet the more gold and silver were poured into it, the poorer it became. Adam Smith says that, except Poland, it was the poorest country in Europe. On the other hand, Scotland is the country which has the least amount of gold and silver currency, with the greatest comparative amount of wealth. The quantity of gold and silver currency in France is much greater than in England, and yet England is much the wealthier country of the two, and there are good grounds for believing that the proportion of currency to industrial operations in England considerably exceeds that in Scotland. These

examples shew that the comparative amount of visible currency in different countries is no evidence whatever, of the comparative wealth of those countries; on the contrary, it may be a proof of waste of wealth, that is, a waste of resources which might be better employed.

74. We must now demonstrate a proposition which is of the greatest importance in Political Economy, and on which errors of the most serious nature are very prevalent; it is this,—*That the quantity of money in any country bears no necessary relation whatever, to the quantity of other goods, &c., in it, or to their price.* Many writers on Political Economy suppose that the quantity of money in a country bears some necessary relation to the quantity of commodities in it; many more think that the prices of commodities are determined by the proportion which the quantity of money bears to the quantity of commodities. That this is a very grievous error can easily be shewn; thus, let us suppose that two persons, A and B are reciprocally indebted to each other for the sale of goods; let us deal in small figures, as that will exhibit the principle of the thing as well as large ones. Let us suppose that A has bought goods of B to the amount of £10, and B has bought goods of A to the amount of £13; then it is quite clear that there are three different ways of settling their dealings.

1. Each may send a clerk to the other with the amount of his debt to the other. To settle the matter in this way would require £23.
2. A may carry £10 to B in discharge of his debt, and B may pay it back to A, together with £3 in discharge of his own. This method would require £13.
3. They may meet and set off their mutual debts against each other, and pay only the difference in coin. This method would require only £3.

Now, it is quite clear that a very different amount of money would be required to carry on any given

amount of business, according as either of these three methods was adopted. Between the first and the third there is a difference of £20; but there would be no difference in the prices of commodities. So that by a simple change in the method of doing business, £20 might be withdrawn from circulation altogether, if only the same quantity of business can be carried on.

75. From these considerations it manifestly appears that there may be very different quantities of money in different countries, which may exercise no influence whatever on prices, and the proportion between money and commodities varies very greatly, according to the method in which business is conducted. Now, it does happen that in different countries all these three methods of carrying on business prevail, the result of which manifestly is, that these countries will require very different quantities of money to carry on the same quantity of business. And it is quite possible that one country in which the first and most troublesome of these methods of carrying on business prevails, may be a much cheaper country than one in which the last and best method prevails. And this was actually the case in France where the first method prevailed, compared to England, where the third method prevails to a much greater extent. It is a well known fact that living in France used to be much cheaper than living in England, although the proportion of money to commodities was very much greater in the former than in the latter, because transactions were settled with ready money to a much greater extent in France than in England.

76. Now, let us suppose that at any given time the operations of a country are conducted by a purely metallic currency to the amount of £1,000,000, say. Then, if persons import money to the further extent of £500,000, such a fresh importation would be an addition to the resources of the country. But three things may happen. *First*, an additional quantity of industry may be generated in exactly the same proportion as the increased quantity of money. If that be the case, no change in prices will occur, but a

great amount of additional wealth may be called into existence. *Secondly*, no additional industry may be generated, and then the extra quantity of money will be forced into the old channel of circulation, and £1,500,000 will now do the same duty that £1,000,000 did before. The only consequence will be that prices will rise 50 per cent., but no additional wealth will be created; and persons who are paid in a fixed quantity of money will find their incomes diminished in value, one-half. *Thirdly*, a result intermediate between these extremes may take place, and additional wealth, to a certain extent, may be created, but not to the full proportion of the additional money; then the result will be both creation of additional wealth to a certain extent, and also a rise in prices, which will manifestly be proportional to the ratio which the surplus, after the creation of additional wealth has ceased, bears to the whole quantity of money employed.

77. Now, if we take the example of a country conducting its operations entirely by the first method above described, and if we suppose that it requires £1,000,000 to settle its transactions, then, if it adopts a change in the method of doing business, and uses the *third* method instead of the first, it is perfectly clear that a very large quantity of money will be disengaged from circulation. That quantity of money being disengaged from previous operations may be applied to promote new ones, and in all its practical effects is an *addition* to the previously existing quantity of money. Hence, the various methods of economizing the use of money are strictly to be considered as an increase of the *resources* of the nation. If by an improved method of doing business, we can dispense with £500,000 in settling transactions, that is equivalent to adding £500,000 to the resources of the nation, and the effects of this addition will be identical with those described in the last section. It is one of the great functions of a Bank to promote such a change of doing business, and to bring people together to balance their mutual debts with-

out the intervention of money ; and we shall shew hereafter how greatly the skilful employment of such methods economizes and develops the national resources.

78. We must now endeavour to settle the meaning of two words, about which there has been much difference of opinion among Political Economists, and upon which most extensive errors prevail. We mean CAPITAL and CREDIT. To fix and define the meaning and extent of the word capital is one of the most important points in the subject, as it has undergone so many Protean changes of signification by writers who use it in different senses, that much confusion has been created. We must enter into some little examination of its nature, and endeavour to discover what is its primary conception, and what its metaphorical and secondary meaning, so that we may always see in what sense it is used. But to do this satisfactorily we must trace its growth from its very first origin.

79. The state of barter which we began by assuming in the beginning of this work, is that which we know did actually prevail in the first ages of the world. Though no doubt the origin of a currency as described there was imaginary, still, if it had been thought of, it would have supplied a remedy for many inconveniences which must have occurred in such a state of things. Thus, when men had done services to their neighbours, and were not paid in money but in kind, if they did not happen to require anything in return at the time, they must, nevertheless, have accepted those things in return, or else have had merely the right to demand them at some future time, which rights or debts would soon have been disputed, or forgotten. Now, if we suppose that the hunter had exchanged some of his produce with a farmer or a shepherd, we may very well suppose that he would not require for his own use all the corn or the sheep which he obtained in return ; so that if this went on for a time, a year say, he would have accumulated a store of corn and sheep, beyond what he had any immediate occasion for. This

accumulation or saving is the first conception of CAPITAL. But the hunter would find it very inconvenient to turn farmer himself, and the corn in his granary could be of no use to him, and would spoil. He would, therefore, probably look for some person who made it his business to grow corn, and he would *lend* him this corn, on condition of receiving an equal quantity back again, together with a certain portion of the increase, by way of reward for the benefit rendered to the farmer. In a similar manner, he would lend his sheep to the shepherd, upon the same condition of receiving part of the increase by way of reward. Such is the first conception of INTEREST or USURY. Thus, we see that capital and interest were conceptions anterior to the use of money.

80. Now, though our conception of the origin of currency is imaginary, this description of the rise of interest or usury is historically true. We know it as a positive historical fact, that the practice of usury existed long before money was invented. Thus, it is well known that there was no money in Greece in the days of Hesiod, yet Hesiod expressly mentions this species of usury.* And Moses classes the two species of usury together. "Take thou no usury of him, *or increase*. Thou shalt not give him this money upon usury, *nor lend him thy victuals for increase*."† This example of the rise of interest is exactly analogous to what prevails in many countries at the present day with respect to *rent*. In some countries it is the custom to give the landlord a certain quantity of the actual produce of the land; though, in more civilized ones, it is commuted into a money payment.

81. It is clear, however, that this primitive mode of accumulating capital would be very inconvenient and burdensome. If any one were to accumulate any considerable quantity, he would require to have large granaries, large flocks, large stores of every kind, which it

* Op. et. Di. 371. † Levit. xxv. 37.

would be a great trouble to look after. Consequently, such a rude way of doing business would have a great tendency to prevent an accumulation of capital. It would greatly obstruct the growth of wealth.

82. In this example, too, we see the first rudimentary form of CREDIT. The person who had accumulated capital, not being able to employ it all himself, would lend it to some one else, on the condition of receiving it back again at a fixed time with interest. In this primitive state, Credit would only consist in the transfer of previously existing Capital from the hands of one person to another, who had more opportunity of applying it in a profitable manner. Consequently, in such a state, Credit would be no increase of capital.

83. Mr. Laing* gives an interesting account of institutions which exist in Norway, which exemplify the whole course of procedure described in the preceding paragraphs. He calls them aptly Corn Banks. In that thinly peopled country, there are no dealers or weekly markets attended by purchasers, who buy at one place and sell at another. If the farmer has any grain to spare, he can do nothing with it, unless he happens by chance to find consumers on the spot. To remedy this inconvenience, magazines are established all over the country, to which the farmers take their surplus grain, and for the time it remains, he receives at the rate of one-eighth of increase per annum, or $12\frac{1}{2}$ per cent. If he deposits eight bushels, he can take out nine at the end of twelve months, or in that proportion for shorter periods, and he is charged at the same rate of one-eighth per annum, for any portions of his quantity he may take out. If he overdraws his account, or had none deposited, but receives a quantity in loan, he pays for such advance at the rate of one-fourth of increase per annum. Thus, if he takes eight bushels, he pays back ten at the end of twelve months, or at that rate for the time he has the loan."

* Residence in Norway, by Samuel Laing. Travellers' Libr. p. 169.

In these primitive Institutions we see actually exemplified the first rudimentary conceptions of Capital, Credit, and Interest, as they may exist anterior to the adoption of money.

84. Reflecting only on these rudimentary conceptions, the principal writers on Political Economy have laid down certain dogmas, which are now part of the established belief on the subject. They are, first, that Credit is only a loan of existing Capital, and, secondly, that production is limited by capital.

85. These propositions are no doubt to a certain extent true, if we do not proceed further than this rudimentary form. But with the introduction of Money, we shall find that a complete revolution takes place in the subject, and we must mark the progress of the details very closely, because the consequences are of great importance, and have been greatly misunderstood. Even at the risk of being tedious, we must start again from the beginning, in order that we may be sure of not missing a single step in the operation.

86. When a man is born without hereditary possessions, and has no property presented to him, there is but one method by which he can live, that is, personal services or labor of some description, either mental or bodily. When such a person has found some one else who stands in need of his services, and employs him, he is entitled to some compensation, or wages. His employer must either give him what he requires directly, such as food, clothing, and shelter, or whatever else may be stipulated, or he must give him something which will enable him to get from some one else, what he requires. That something, which is not an equivalent itself, but *only the means of obtaining an equivalent*, is MONEY. This latter method of rewarding services has been almost universally adopted among civilized nations. Now, when the laborer has received his wages in money, he has not received an equivalent for his labor, but only something which will enable him to get what he requires, or chooses. The money,

therefore, that he possesses is not *the equivalent*, but it is the symbol or proof that he has rendered services for which he has NOT YET RECEIVED AN EQUIVALENT. The laborer does not receive the coin for its own sake. The actual silver can be of no use to him directly. But it is the universally recognised and accepted power of commanding what he wants. Now, if the laborer spends all his money in buying commodities for use, it is clear that at the end of the year he is in no better condition than he was at the beginning. There is nothing but the same weary round of toil before him. He must again enter on a similar course of labor, or personal services, to earn again the means of subsistence, and so on for all his life. But suppose that, instead of spending all his earnings on commodities, he *saves* a portion of them; then his condition at the end of the year is better by just so much as he has saved. And that saving represents such portion of his services rendered for which he has not yet received an equivalent. And that saving is called CAPITAL. Whether it be a penny, a shilling, or a pound, that is the first germ of Capital; and the more the laborer saves from spending the more does his capital grow. The part of the money he spends we may denominate REVENUE, and the part that he saves is CAPITAL. Hence, *the fundamental idea of Capital is the store of accumulated labor which its owner has not yet spent in purchasing commodities*. It does not represent commodities in any way whatever, but only the power its owner has of purchasing what he wants. It is also manifest that it bears no definite relation to commodities, because the quantity of capital the laborer accumulates is just the quantity he refrains from spending.

87. Such, then, since the introduction of money, is the fundamental conception of Capital. It is, therefore, nothing but a store of accumulated labor which has not yet been spent, and it is necessary to have some material substance to represent and measure it, and that substance is money. Capital, then, in its primary, genuine, and original meaning, denotes the accumulated savings of

labor, and its symbol is money. The first meaning which every man in business attaches to the expression, Capital, is money. Thus, a capitalist is, technically, a person who has a large stock of ready *money* at his disposal. To bring Capital into a business, is to bring money into a concern. When a man is said not to have sufficient Capital to carry on a business, it means that he has not a sufficient command of ready money.

88. Now, as soon as persons began to labor for hire, it became necessary to fix upon some substance to represent labor, which should be received as the general power of commanding services. And it also became necessary that a specific *quantity* of that substance so selected, should represent a specific quantity of labor. Different nations have selected different substances—some tobacco, some chocolate, some sugar, some shells, some leather, but they all selected some particular *substance* for this purpose. The most civilized nations have, however, both in ancient and modern times, given the preference to two particular substances, above all others, for this particular purpose, and these are gold and silver bullion. It has, also, always been settled among these nations that the *quantity* of bullion is always proportional to the value of the service, at the time it is rendered. Not that the same quantity of bullion will always command the same amount of service or commodities at different times, but at the same time one-half of the quantity of bullion will only command one-half the quantity of services. Among all these nations, then, the *weight of bullion is the measure of value*. We must be especially careful not to imagine that the measure of value is an abstract thing, like a foot or a yard the measure of length, or a pound the measure of weight. A length of rope which measures twenty yards to-day, will do so to-morrow, or a year hence. It will be of the same length at London, or in Calcutta. A quantity of lead which weighs twenty pounds to-day will do the same to-morrow, or a year hence. It will weigh twenty pounds in any part of the world. But value

is always measured by the relative quantities in which two substances will exchange, and may vary from hour to hour, or from day to day. A quarter of wheat may be worth 50s. to-day, and 60s. to-morrow, and 120s. three months hence. Still less is it likely that they will have the same exchangeable relation in different countries. Also, if there were twenty thousand million yard measures in the country, that would make no difference in the length of the rope, nor if there were twenty thousand millions of pound weights, would that make any difference in the weight of the lead; but if twenty thousand million sovereigns were suddenly introduced into the country, that would very probably make a difference in the exchangeable relations of gold, and other commodities. Hence, when we speak of a measure of value, we do not speak of an absolute invariable measure, like that of length or weight, but only of one which affords a convenient method of comparing the exchangeable relations of quantities at any given time or place. The quantity of substance which was the original measure of value in England, Scotland, and France, was *a pound weight of silver bullion of a definite fineness*.

89. Now, let us suppose that our laborer having accumulated a store of capital, *i. e.*, of its symbol, money, by abstaining from spending his earnings as revenue, or has a quantity of it given him, which is merely the result and the accumulated store of some one else's labor, and becomes a merchant or trader, let us trace the operation of capital, and its change of meaning then.

90. The object of commerce, and the business of every merchant and trader, is to cause a circulation of commodities, to bring commodities from persons who have more than they require, to persons who have less than they require. As soon as a merchant, or trader, has discovered persons in this condition, it is his business to step in and restore the equilibrium, and this he does by buying commodities from persons who have too much, and selling them to those who have too little.

The greater the stream of commodities he can cause to pass through his hands, the greater will be his profit. Now, as the commencement of his operation must be buying the goods he means to sell, what is the *power* which enables him to purchase them? CAPITAL. Capital is, therefore, the purchasing power, the moving power of commerce, the power that causes the goods to move from the producer to the merchant, or it is the *circulating* power, which causes the goods to circulate. In its primary meaning, it does not mean the commodities themselves, but the *power* which transfers the property in them from one person to another. And that this was the use of money in commerce both Adam Smith and Ricardo saw clearly.

91. But the object of the merchant in buying the goods, is not to keep them to himself, but to sell them to other people, and to sell them for as much more than he gave for them, as possible. The obtaining the goods in the first instance, was only a means to an end. The true object of the merchant is to possess more money at the end of the transaction than at the beginning. If he gave £1,000 for the goods, he hopes, perhaps, to receive £1,500 for them. Thus, in their turn, the goods become the moving power, the purchasing power of this £1,500, and consequently, by a simple transition, the name of capital is applied in a secondary, and metaphorical, sense to the goods which are the moving power to enable him to get possession of the £1,500. When a man has bought goods and sold them, he is said, in mercantile language, to *turn over* his capital. Hence, it must never be forgotten, that the original and primary sense of capital is the circulating power of commerce, and that when applied to commodities, it is only in a secondary and metaphorical sense, because they complete, as we may say, the revolution of capital.

92. But the word capital is capable of a still further metaphorical extension of its original and primary meaning. As the object of every man's labor is to gain money,

whatever conduces to that end may, in a figurative sense, be denominated *capital*. When a man invests money as capital, viz., with a view to make a profit, the precise form in which he invests it can make no difference in the principle. One man invests his money in cultivating a farm, for the purpose of selling the produce ; another man invests money in buying commodities, for the purpose of selling them with a profit ; another invests his money in cultivating his mind, by learning a profession, for the purpose of making a profit by exercising that profession. As a question of Political Economy all these modes of investing capital must be treated in the same way. They must be classed together, though they may be distinguished as far as regards the species. Thus, one may be called material capital, and the other personal, moral, intellectual, or immaterial capital.

93. Capital, then, in its most extended and general sense, which is the proper one to be employed in Political Economy, may be said to be anything which a man can trade with, or which he can turn to the purposes of profit, or which helps him to gain an income. Any property or quality he possesses, which enables him to increase his wealth, any instrument however humble, or any contrivance however simple, which abridges labor, and increases production, is truly to be ranked as capital. Thus, the tools of an artizan, together with his skill and industry, form his capital. The education and books, and the skill of a physician, and lawyer, are their capital ; the goods of a trader, and his skill and judgment, are his capital ; the land of a landlord is his capital, which he cultivates himself, or lets to farmers. So a good character serves as capital to many persons who can obtain the use of money, or a situation, from their known integrity. Now, with these elementary truths clearly impressed upon us, we shall be at no loss in any case to understand the meaning of *capital*, whether used in its original and genuine sense, or in its derived and metaphorical one.

94. But a man's integrity, skill, and judgment, may serve him as capital, in a much more direct sense than the latter one we have just spoken of, namely, as the direct circulating power of commodities. When the merchant bought goods with capital, he invested a portion of the realized symbol of his *past* skill, judgment, and industry. But mercantile instinct devised a circulating power which should be the symbol of *future* skill, judgment, and industry, and this circulating power is CREDIT. The merchant, instead of buying goods with actual money, is allowed to buy them with a "promise to pay" money at some future period. By paying money he gives the result of his former industry, by buying with a "promise to pay" money, he pledges the result of his future industry. The actual money out of which payment is to be made for them, is to be obtained by his future labor, skill, and judgment in selling them advantageously. *Money, labor, and credit represent simply industry past, present, and future.* Now, this system of buying goods with a "promise to pay," is called the SYSTEM OF CREDIT. It must be carefully observed that these goods are not advanced as a mere *loan*, but the property of them passes to the buyer equally whether the operation be by actual payment, or only by a "promise of payment." Whenever, therefore, sales are made upon credit, *credit is equally a circulating power with real capital.*

95. Now, let us examine the result to the merchant, according as he employs capital, or credit, as purchasing power.

If he possesses £1,000 of capital, at the beginning of the transaction, and invests it in commodities, and sells them for £1,500, he is better off, at the end of the transaction, by the sum of £500, which forms his *profit*.

If he buys them with his "promise to pay," the producer makes a difference ; he stipulates to have a somewhat higher payment, in consideration of its being postponed, and that according to the length of the postponement. Thus, if he sold for ready money for £1,000, if the

payment was postponed for a year, he would probably demand £1,100, and so in proportion for any lesser time. Now, if the merchant bought upon these terms, if he bought the goods with a promise to pay £1,100 at the end of the year, and if he sold them, as before supposed, for £1,500, his profit at the end of the operation would only be £400, instead of £500, and this difference of £100 is called the *discount*. Hence, credit is less profitable to the merchant than capital by the discount.

96. Hence, we see, that so far as regards the circulation of commodities, credit performs exactly the same function as capital. A merchant makes a profit by trading upon credit, not so great a profit, it is true, as if he were trading with real capital, but yet, if he has credit, he makes a profit where otherwise he would make none. Hence, it follows according to the conception of capital, that credit is capital. All goods are circulated, either by capital, or by credit; hence, *capital and credit constitute the circulating medium*.

97. What we have already said must suffice in this place to shew the first principles of capital and credit. The system of credit, however, is of such transcendent importance in Political Economy and commerce, and it has been so completely misunderstood by writers on Political Economy, that it requires to be thoroughly investigated and described, and the whole details of the system will be exhibited in a future chapter.

98. We have observed in our preliminary remarks, that the earlier writers on Political Economy only considered the subject as far as related to material capital, or material products, and that subsequent writers have extended it to include mental capital, or mental wealth, in which they are unquestionably correct. Because intellectual capital is just as much a source of profit to its owner as a farm or a manufactory. No doubt it is liable to perish, but that does not invalidate in any way its being capital, or wealth, as long as it exists. So, any accomplishments, or any profession whatever, by which persons gain their live-

lihood, are capital to them. The powers of singing and dancing possessed by performers at the opera are capital to them. To say that their labour produces nothing permanent is nothing to the purpose, because the very same objection would be applicable to an immense quantity of material products which are produced for the very purpose of being destroyed. Thus, no one would deny that a cigar is capital to the tobacco merchant. The tobacco grower sees that men like smoking, and he expends his time, labour, and money in producing something to minister to that want. So an opera singer perceives that such qualifications are desired by men, who are ready to pay for their enjoyment. He expends his time, labour, and money in cultivating his powers, which enable him to produce something that will minister to that desire. How is the song which he can produce less capital to him than the cigar to the tobacco merchant? They each of them perish in the using, but they are both equally sources of profit to the person who can supply them. They are both equally subjects of sale, and, therefore, of property.

99. From the foregoing considerations, then, it will be seen that, in its most general sense, the word capital is rather to be applied to the method of employing a quality, than to any particular thing. It is impossible to say that such an article is capital, and such another article is not capital, because everything depends upon the method of employing them. We must rather speak of things being employed as capital. Thus, a farmer has a quantity of corn, it is impossible to say whether it is capital until we know how he is going to employ it. It is not possible to say absolutely that this parcel of wheat is capital, and this parcel of wheat is not capital. The fact is, the part that he sows again is capital, the part he uses for his own consumption is not capital; and so of other things. And so with mental acquirements; when they are employed so as to produce an income they are capital. It is quite impossible to restrain the word capital to material products; because towards the general end, which is profit, the

qualities of the mind are equally essential as the material product. If the guiding mind be wanting, the material product is barren and useless. Each of them, then, is an equally necessary ingredient of the result. The qualities of the mind are the subject of commerce in exactly the same manner as material products.

100. But even the writers who have admitted and established these principles have stopped short there; and they have failed to recognize an immense body of property which falls under neither of these heads, and which yet is the subject of bargain and sale, and is an article of commerce just as much as any existing property. And this comprehends all future payments, annuities, and incorporeal rights, reversionary payments, and vested interests, which cannot by any possibility be excluded from the bounds of Political Economy, and which are each of them separate and independent values. All certain future payments have a present value, as it is called, which is an article of commerce, and saleable just like merchandize. A sum of money which is payable one year hence, has a PRESENT VALUE, which is a marketable commodity, quite independent of the actual money in which it may ultimately be paid; it may be bought and sold, just like a table, or a chair. Upon this doctrine rests the whole of commercial credit, which consists in Bills of Exchange. A Bill of Exchange is usually a deferred payment, but it has a present value; it is a saleable commodity, and has an independent value, just as much as a loaf of bread; and this present value is perfectly independent of the money it will ultimately be paid in. Some idea of the enormous value of this species of property may be gathered from the fact, that the quantity of it consisting of bills of exchange alone is about £500,000,000; and what it may amount to in the other things of this nature, it is utterly impossible even to conjecture.

101. Now, it is a point of the most fundamental importance to understand clearly that this enormous amount of property, in bills of exchange, is an independent value. It

does not represent any particular sum of money whatever, still less any commodities, on which there is a very common delusion. But it is property of separate value to that amount, perfectly different from dock warrants and bills of lading, which merely represent so much specific property.

102. A total misconception on this point is one of the subjects on which the established doctrines of Political Economy are preeminently defective, and to illustrate the matter more clearly, let us take an example. It must be clearly understood, then, that because a man has made an engagement to make a payment at a future time, he is not in debt until that time comes; it is no diminution of his actual property. Thus, take the case of a farmer who makes an engagement to pay rent year by year for a farm: now, though he has made an engagement to make a payment next year, he is not in debt at present; that future payment is no diminution of his actual existing property. But yet that future payment to be made by him has a present value. It may be bought and sold like other merchandize, and, in fact, it is by adding up a series of these deferred payments that the value of an estate is estimated. Now, these future payments to be made by the farmer are exactly like bills of exchange, payable at these respective dates; but though the farmer is under this series of engagements, he is not in debt at the present time. They are no diminution of his present property; they are merely a lien upon future property. Nor does the engagement the farmer has made to pay the rent in future times, represent any particular sum of money; its present value is a value quite independent of any sum of money. It is exactly the same with a merchant who has accepted a bill of exchange. It is merely an engagement to make a future payment, and is no diminution of his actual property, and is perfectly independent of any particular sum of money. And the same reasoning is true of the general amount of bills of exchange.

103. Hence, we must understand as the very foundation of the subject, that a bill of exchange is an independent

value, just like a house, or a ship, or a horse, or money itself, - every single thing that can be bought and sold is a separate value.

104. Now, the property which exists in this country of this colossal magnitude, is almost entirely the child of modern civilization and intelligence. It depends purely on confidence, and is subject to be annihilated by the destruction of the quality it is based upon. And it must be understood that the destruction of this, is the destruction of a real value, just like the destruction of so much capital of any other sort. So that, as credit is capital, a destruction of credit is a destruction of capital. Having in this place indicated the existence, and described the nature of this series of property, we shall in the next chapter, which is its appropriate place, show how the value of such property is estimated.

105. The object of the employment of capital is that it may replace itself, together with a certain increase. This increase, or excess of return over the original expenditure, is called the PROFIT, and its magnitude, or rate, is estimated not simply by its absolute amount, but also by the *time* required to produce it. The standard of estimating the rate of profit is usually the year; so it is said that the rate of profit is so much per cent. per annum. It is quite clear that when we hear that so much profit has been made by any operation, it is impossible to judge whether it is much or little, unless the time in which it took to accrue is also given. If an operation produce a profit of 5 per cent. in three months, it is a very different thing to what it would be, if it took a year or more to produce that excess.

106. Capital may be employed in two ways. First, it may be invested in objects which are meant to be sold, and then the whole of the original sum, together with the excess, or profit, may be recovered in one operation. When employed in this way, it, or the objects in which it is invested, is termed FLOATING, or CIRCULATING CAPITAL, because it goes altogether away from the owner.

Secondly, it may be invested in objects which are not meant to be sold and parted with, but which remain with the owner and yield him a profit by their use. When employed in this way, it, or the objects in which it is invested, is termed **FIXED CAPITAL**.

107. It is clear that if the return be made in one operation, it must include the whole sum necessary to replace the article, as well as the intended profits. But if the return be made by instalments at fixed periods, say a year, each instalment must consist of a sum partly to replace the deterioration of the article itself during that period, and partly to form the excess, or profit, of the capitalist, so at the end of the term when the article is worn out, the sum of all these instalments should be sufficient to replace the original article together with the profits.

108. It is clearly to be understood, that it is according to the intention of the person who produces an article, and the purpose for which it is produced, that it receives either of these names, and not according to the nature of the article itself. The same article may receive different names, according as it passes to different owners, who produce it, or cause it to be produced for different purposes. The same article may be *floating capital* in the hands of one man, and *fixed capital* in the hands of its next possessor, if the first produces it for the purpose of selling it, and the second purchases it for the purpose deriving an income from its use.

109. This distinction may also be stated thus. That if the whole price of the article is paid out of the current income of the country, it is *floating capital*; but if only the interest, a revenue derived from its use, then it is *fixed capital*. This distinction is often overlooked, and the term fixed capital is applied to articles of a certain nature, and floating capital to articles of another nature. Thus, houses and lands, machinery, railways, and ships are frequently termed fixed capital. But this is extremely erroneous. If a person employs his capital in build-

ing houses for the purpose of selling them immediately, they are floating capital in his hands, for their price is paid in one operation. But if another man buys them for the purpose of letting them out to tenants, and so only deriving a revenue from his capital, they become fixed capital in his hands. Many persons buy land on speculation, for the purpose of selling it again at a profit. The land in the hands of these jobbers is *floating capital*, but if another buys that land for the purpose of letting it out to farmers, or cultivating it himself, and so only making a revenue of it, it becomes *fixed capital* to him. So with machinery; to the machine maker, who makes it for the purpose of selling it to the manufacturer, it is floating capital. In the hands of the manufacturer, who buys it for the purpose of increasing the quantity of his productions by its use, and so only making a profit of it, it becomes *fixed capital*. Hence, we may state generally, that all articles whatever be their nature, while they are in the hands of a person who deals in them, that is, who produces or buys them for the purpose of selling them again, as soon as he can, are *floating capital*. As soon as they pass into the hands of a person, who only makes a profit by interest derivable from their use, they are *fixed capital*.

110. The articles we have just mentioned are, it is true, generally produced with the intention of their ultimately becoming fixed capital, but we have shewn that they may, or they may not, be fixed capital, when they are produced, according to different circumstances, and unless we know what those circumstances are, it is impossible to decide which name is to be given to them. It may also be easily shewn how articles which are usually classed as floating capital, may become fixed capital. Furniture and clothes would usually be termed floating capital, because they are generally made for the purpose of being sold. But if a person made them for the purpose of only letting them out for hire, they would become fixed capital in his hands. An ordinary tailor

usually makes clothes to be sold to his customers, so they are floating capital to him. But in the hands of Nathan, who lets out uniforms and dresses for particular occasions, they become fixed capital, just as much as a house or a mill. So, if a cabinet maker makes furniture, for the purpose of letting it out for hire, that furniture is as much *fixed capital* as any railway.

111. We thus see how improper it is to apply the term either of floating, or fixed capital to any object, whatever be its nature, unless we know the intention of its owner in using it. And unless an article is incapable of being applied to more than one of these purposes, it is not correct to call it by either name. There are very few articles to which the name of fixed capital may be invariably applied, none to which it is necessarily applied. Those to which it may be applied with the least risk of error are Railways, Canals, Docks, and agricultural improvements. The instances are very rare in which such things as Railways, &c., are made for the purpose of being sold. If that did happen, they would have to be called floating capital, in the hands of such a person, or company. So that we may safely say, that there are no articles which are necessarily fixed capital. Nor are there any which are necessarily floating capital. The mode of expending capital, which is almost invariably floating capital, is the wages of labor. In all ordinary cases in this country the wages of labor are floating capital. But in slave countries the case is different. There the slaves are fixed capital. The same thing occurs in this country, where people sometimes enter as it were into a species of modified servitude. Sometimes people hire themselves out to others for a certain period, who are allowed to let them out for particular occasions, and receive the money for their performances. Thus, it is not unusual for the most eminent singers and musicians, to agree to serve the large music sellers for a definite period, during which their employer has the right

to let them out on occasions, just like instruments, or plate.

112. To the capitalist who lives merely on the profits of his capital, it may make very little difference whether he reaps that profit in one operation or in many, as the result must always be the same to him in the end. But to the class of persons who live by their daily labor—the workmen in his business—the difference in the mode of employing capital is of vital importance. Thus, if the builder of a ship means to sell it immediately, and be paid the whole price of it at once, he will employ that money in building another ship, and the full amount of the price of the ship, deducting the part which goes to support himself, will be expended in the wages of the shipwrights, and on the producers of the materials for the new ship. In this case it is floating capital. But if the builder of the ship means only to let it out for hire, and receive a periodical instalment for its use, he can only employ the part of that instalment which represents its deterioration in building a new ship; consequently, if he changes the nature of his business very suddenly, that is, if he suddenly turns his floating into fixed capital, the fund applicable to the promotion of labor will be greatly diminished, and it must infallibly cause great distress among the persons who were dependent on him for their support. By seeking other employments they may, perhaps, ultimately be as well off as before; but it is quite clear that if a large number of persons have been accustomed to have a particular kind of labor found for them, any sudden change by which the system is disorganized, must produce at least temporary distress. It might be said that the capital of the purchaser of the ship, instead of going to the builder of the ship, and being spent among that class of workmen, might be employed in encouraging other species of industry, so that the result to the whole community would be the same. But the overthrow of any system upon which a great number of

people depend, must be followed by much suffering. It appears, then, that the conversion of floating into fixed capital, requires to be done with great caution, and only in certain quantities, to avoid its being injurious to the interests of large classes of persons. And if a large class of the public are seized with a sudden mania to convert an unusual quantity of their floating into fixed capital, it must inevitably be followed by at least temporary distress.

113. We have observed that, if the owner of an article disposes of its use for ever, or sells it, the price should be sufficient to replace the article, together with the profits. When he only lets it, the rent or hire is composed of one part for the deterioration of the article, and the other for the necessary profits. From this it follows, that the more permanent the article is, the lower will be the rent, or hire, compared to the price, because, assuming the profits to be the same, the deterioration is less during any given time. If it be of a perishable nature, the hire will be high compared to the price, because the deterioration will be great. A few cases will verify this remark. The rent of land is very low, compared with its price, usually not more than 3 or 4 per cent., because the deterioration is very small. The rent of houses is much greater compared to their price, usually $7\frac{1}{2}$ or 8 per cent., because the deterioration is greater; the hire of furniture is considerably more, usually 15 or 20 per cent., because the deterioration is greater still, and so on, so that the hire must always be greater as the deterioration increases. From this it follows, that the hire of any article is by no means proportional to its value. Some important questions connected with these considerations will occur hereafter.

114. When the absolute property of any article is transferred for ever, from one person to another, the sum of money given for it is universally termed its PRICE. From the considerations presented in the opening paragraphs, it appears that the *price* is the same thing as the

value in money. But as it is invariably usual to estimate the value of every commodity by its price, or its value as regards money, and never by its value as regards other commodities directly, but always by their common relation to money, the words *price* and *value* have become identical and interchangeable expressions. The price, or value of an article is, therefore, the quantity of legal coin that is given in exchange for any commodity. There is one species, however, of incorporeal property of a very extensive nature, whose price or value is estimated in a peculiar manner, which must be explained, and that is the price of *debts*. In modern commerce the sale of debts plays a part of immense importance. A debt is considered as a saleable commodity, exactly like a quarter of corn, or a ship, and may be bought and sold a hundred times over. The business of Banking consists chiefly in buying and selling debts. Now, the price of debts is expressed in a peculiar way. It is necessary to have some unit of debt. Now, debts are measured by time, and we may take £100 payable one year hence, as the unit of debt. When a man buys a debt, he pays a sum of money down, and the difference between the price of the debt and the amount of the debt is called the *Discount*, which forms his profit. Now, if a man buys a debt of £100, payable one year hence, for £97, the discount is said to be 3 per cent. And the price of debts is always indicated by naming the *discount*, and never by the price, as is usual in all other cases. Buying and selling debts is the subject of the system of credit, the details of which are fully exhibited in Chapter III.

115. If the absolute property does not pass to the purchaser, but only the right of possession, or of use, for a limited period, after which it reverts to its true owner, the sum of money paid for such a service receives different names, according to the nature of the service or property.

1. If the money be paid for personal services, it is called *WAGES*, or *SALARY*, or *PAY*, or *FEES*, according to the different species of service.

2. If the money is paid for the use of property, such as is usually classed as *fixed capital*, such as the right to use land, or houses, or running water, as a mill stream, or mines, or fisheries, or a patent, it is called RENT.
3. If for the use of property which is more usually floating capital, or personal property, it is called HIRE.
4. If it is for the use of money, it is called INTEREST.

All these names are, therefore, applied, when the purchaser buys only the use of a thing for a limited period, and that according to the nature of the object.

116. The expression VALUE OF MONEY, denotes exactly the same thing as the value of anything else. It means the relative quantities in which money and other objects will exchange. And money is said to rise or fall in value in the inverse proportions in which it will exchange with other things. The value of money is said to rise, to be greater, when a smaller quantity of money will exchange for objects, and to fall or be less when it requires a greater quantity of money to purchase commodities. With respect to the price of debts, however, which are estimated by the discount, and not by the actual price, it is clear that the value of money rises and falls with the discount. Thus, by the former sentence the value of money is greater when the price of the unit of debt is £94, than when it is £97. That is, when the discount is £6 per cent. than when it is £3 per cent. Hence, the value of money always varies inversely as Price, and directly as Discount. To discover and accurately express the causes of the changes in the Value of Money, is the grand problem in Political Economy. It is, in fact, to discover the laws which regulate the exchangeable relations of quantities which constitutes, according to the views we adopt, the Science of Political Economy. Under its appropriate name, the THEORY OF PRICES, it is fully treated in the next chapter, and the succeeding ones are chiefly developments of particular cases of it.

117. The word **PRODUCTION** is used in different senses by different writers. Some consider the term to be limited to making some material change in the form of the materials, of which the objects are composed, or some combination of materials. Thus, changing the form of the wool or the cotton into thread, or weaving that thread into cloth, or dyeing the cloth—or sowing the corn and reaping the harvest—grinding the produce into flour—and baking the flour into bread—are operations universally classed under the term **Production**. All persons engaged in them are termed **producers**. Some writers hold that there is another class of persons who *distribute* the things so produced. These operations are treated of under the heads **Production and Distribution**. This distinction is not perhaps incorrect, but it is unnecessary and superfluous. It is more simple to group together, under one head, all the persons and operations necessary to place any required object in a given spot. All production is summed up, in placing an object on the spot in which it is required. Thus, if production were limited to the persons only who change the form of the materials, we might in strictness say, that those persons who are employed in carrying the produce from the mills to the warehouse were distributors. Now, if the carmen and labourers who convey the materials to the mills, or the produce of the mills to the warehouse, are to be classed with producers, it is merely an extension of the same principle to class the shopkeepers and tradesmen, who order the goods from the manufacturer to meet the expected demand from their customers, under the general head of producers. As far as regards the customer who buys the article, the tradesman in whose shop he buys it is the producer. What difference can it make, whether that tradesman paid wages to workmen in his direct employment, and carried the article from his workshop to his counter, or whether he pays an independent manufacturer in a town 100 miles off, and transports it from that place to his own shop? So far as regards the customer,

the person for whom the goods were made, the shopkeeper is the producer. This view not only simplifies the matter by abolishing an unnecessary distinction, but has the further advantage of strictly corresponding with the genuine meaning of the word *produce*. To *produce* in English does not mean simply to manufacture, or to form, but to *bring out*, to place in a given spot. Thus, in Isaiah xli. 21, it is said, "*Produce* your cause, saith the Lord, *bring forth* your strong reasons, saith the King of Jacob. Let them bring forth and shew us what shall happen." And the marginal note says, "Produce—*cause to come near*." And they were not told to make strong reasons, but to bring out the existing reasons. So also in a Court of Law, a witness is ordered to *produce* a deed, *i. e.*, not to write it, but to bring it out, and place it in a required place. So the gaoler is ordered to *produce* the body of his prisoner, *i. e.*, not to manufacture him, but to place him in Court. So when any person is ordered to produce anything, it usually means simply to bring it forth.

118. In a general way, then, the person who places a required article on any given spot, is, for the purposes of Political Economy, to be considered as the producer of that article, whatever be the means adopted for placing it there. By a very common philosophical inaccuracy, the word production is frequently applied both to the act of producing, and to the thing produced, though the word product or produce, is frequently used in the latter sense. It is better to limit the term production to the operation, and to denominate the quantity produced by the word SUPPLY.

119. There has also been much difference of opinion as to the meaning of the word CONSUMPTION. Some considering it to imply destruction. But we shall use it simply in the sense of sale. When we speak of the consumption of an article we mean simply the *quantity sold*. The producer is the person who brings forward the

article for sale, the consumer is the person who takes it off, by purchasing it. And as the quantity produced is the supply, so the quantity sold is the demand. Thus, the terms Production and Consumption, Supply and Demand, mean nothing more than the quantity offered for sale, and the quantity sold.

120. Although people are not divided into producers and consumers generally, yet in respect to each particular article they are. Nor is it any objection that some are both producers and consumers of the same article, as a farmer is of corn, and a cloth manufacturer is of clothes, a baker of bread, &c. Nothing is more common than for a man to act in two capacities, apparently inconsistent with one another. Thus, a man may lend to himself, and borrow from himself. He may be the Shareholder in a Joint Stock Bank, and also be a customer of that Bank, and he may borrow money from that Bank. He, therefore, both lends to and borrows from himself. He is both his own Banker, and his own customer.

121. The series of persons who deal in any article of commerce are alternately consumers and producers of that article. Thus, the foreign merchant or the importer, is a consumer of that article as regards the foreigner, he is then a producer of that article as regards the wholesale dealer. The wholesale dealer is a consumer as regards the importer, but a producer as regards the retail dealer. The retail dealer is a consumer as regards the wholesale dealer, and a producer as regards his customer, who is the final consumer, and for whom all the series of previous operations took place.

122. Possessions or Property of all sorts, may be divided into *Wealth* and *Resources*. By the former we denote all such objects as men seek to acquire for their own sakes, and their own qualities, and which are in a fit state for actual use, and such as are not merely agents in the production of others. By resources we mean all such things, of whatever nature they may be, which are employed as agents in producing others, and which are not

directly useful, but only so far as they produce a profit, or which may be brought into use, but are not yet in a fit condition to be used. Thus, while the minerals and coals are still in the mine, or the fish in the sea, we call them resources; when they are actually got and reduced into possession, we may call them wealth. It is only necessary to consider what is the object of any particular thing, to determine under which head it is to be classed. It is absolutely necessary to understand clearly the distinction between these two classes of possessions, because it often happens that as one is increased, the other is diminished. The wealth of a country is not to be estimated by the actual amount of commodities it has at any given moment, but by the power it has of producing any required amount, in the shortest time, or by its command over production. This consideration shews that the increase of the wealth of a country, is not caused so much by having more commodities in it, as by the augmentation of its wealth-producing powers, or its resources. A country may often be the most really wealthy, when it has the least amount of visible wealth. Since the introduction of railways, and the increased facilities of communication, it is probably not necessary to keep in store more than one fourth part of what was formerly requisite of many commodities. In the old days of pack-horses it took perhaps fifteen days to transport any quantity of goods from Manchester to London. Consequently to supply the stream of demand, it was manifestly necessary to have fifteen times a day's consumption in existence, and on the road. When the canal reduced the time of transport, to five days, the necessary quantity in existence was reduced to five days' consumption. And when the railroad reduced the journey to one day, it was evidently necessary only to have one day's consumption on the road. But it would be a grievous error to suppose that the nation was less wealthy, because there were not so many commodities in existence, at any given instant. On the contrary, the nation is far more wealthy on that account. Though

they are not in existence, any one who requires them, can have them called into existence, far more easily than formerly. If an order be sent from London to Manchester for goods, these can be supplied in days now, where it would formerly have taken weeks, or months. Hence, the wealth of a country is not to be judged of by the quantity of goods it has in stock at any given instant, but by the speed with which it can supply any given demand. The very fact of a great abundance of stock may prove poverty of resource. If we see a canal with a multitude of reservoirs along its banks, we immediately conclude that the supply of water is apt to fail. People do not lock up a great deal of their capital in stock, unless a failure of resources is apprehended. If the supply of water is steady, there is no need of reservoirs, so if the supply of goods is sure, there is no need of an accumulation of stock. Now, money is to be classed under the term resources. People of right mind do not seek to obtain money for its own sake, any more than they build mills, or manufactories, or steam engines, for their own sakes, but for the power they confer of producing commodities. No one would buy a cotton mill, for the mere pleasure of possessing the machinery, as he would a house, or a picture.

123. A country, then, which abounds with gold and silver coin, cannot properly be said to be wealthy, any more than one which abounds with machinery. So long as these stand idle, the country must remain poor, like a manufacturing town in a strike. It is their motion or circulation, which generates wealth, and the rapidity of that circulation, which indicates the rate of increase or progress. This consideration will enable us to solve a question, which was long agitated by Political Economists and statesmen. Which employment conduces most to national opulence? From the time of Colbert, to the French Revolution, the question whether the towns or the country most conduced to national wealth, was keenly disputed, and according as one side or the other

prevailed, the one was encouraged and cockered, and the other depressed. Now, as the velocity of the circulation indicates the rate of progress, whatever employment causes currency to circulate with the greatest rapidity, most augments national opulence. Currency is the engine of circulation, and industry is its motive power, whichever species of industry drives the engine fastest, most rapidly augments the national wealth. Now, it is well known that of all species of industry, agriculture causes the most languid circulation of the currency. By offering an extra stimulus of reward, the productions of human industry can be multiplied and quickened to an extraordinary extent, but the process of nature is slow, and cannot be accelerated at command. Different trading pursuits cause a brisker circulation, in different degrees—all much faster than agriculture. Hence, a purely agricultural country must increase slower in opulence, than any other, and other countries very much in the proportion of their inhabitants engaged in agriculture, as compared to other pursuits. Experience amply verifies this remark. Poland and other countries, which have few resources but agriculture, are the poorest and most barbarous in Europe. Great Britain and Holland, in which the smallest proportion of the inhabitants are engaged in raising food for the rest, are the wealthiest, and other countries very much in similar proportions. The instances are not many, in which people have made fortunes by agriculture, but there is scarcely probably a small country town, where some industrious and energetic individuals have not realized a competence, by trading.

124. From the extravagant and mistaken ideas that prevailed as to gold and silver money being wealth, there are few nations which have not inflicted upon themselves incalculable mischief by their commercial policy. When the Spaniards discovered and conquered the gold-producing districts of America, they thought that nothing but gold and silver was wealth. Dazzled with the brilliant prospect

of becoming wealthy without labor, they imagined that the whole of their well being consisted in amassing enormous heaps of gold and silver, wholly mistaking the means for the end, and not discerning that the precious metals were only precious so long as they were used for setting human industry in motion, while they encouraged the tilling of the land, the mother of increase, or the building of ships to promote the intercourse of nations, or plying the loom to produce clothing for mankind.

125. It would be beyond the limits of this work to dwell upon their well-known policy, and its fatal results. While the precious metals poured in in boundless quantities, till the country was saturated with gold and silver, which the people of that day thought would make them the rulers of the world, it began, immediately, to decline in wealth, and continued to dwindle away till, at last, she presents the melancholy spectacle we now see, when she is reduced to the lowest depths of poverty, weakness, dishonesty, and contempt. Never has the world seen a country blessed by so many resources by nature, so suddenly and rapidly descend from so lofty an eminence to such a pitch of degradation; and it was, emphatically, wicked and unjust laws, and erroneous ideas respecting the value of gold and silver, that did it all. Spain fairly earned the eminence she attained to, by her industry and energy, and nothing could be more useful or instructive to statesmen and to people, to show how a great state may be ruined by evil legislation on such subjects,—to shew how to reverse the boast of Themistocles—than a plain and simple history of the terrible catastrophe of Spanish grandeur. So it was with Napoleon. He was perpetually hurling taunts at Political Economists, and it was precisely because he violated every principle of Political Economy, that he ruined his country and himself. The legislation of this country was, for a considerable period, tainted with similar errors, though in a milder form, and they produced consequences, the same in kind but less in degree, owing to the innate industry and indomitable energy of the

people, who at last discovered their mischief and burst their fetters.

126. The absolute amount of the currency, compared to the services it represents, varies in different countries. When its proportion in one country greatly exceeds that of its neighbours, it is a very great evil, because the cost of producing anything in that country is so much higher than in the neighbouring ones, that it is far cheaper to import goods than to produce them at home, and so native industry languishes and dies. It was this cause (joined to others of which it is not necessary to speak here,) that destroyed the industry, and with it the power of Spain. The Spaniards endeavoured to counteract the evil effects, which were so apparent, by absolutely prohibiting the importation of foreign goods, so as to compel native production, and if it had been possible to exclude foreign commerce entirely, the price of every article being raised correspondingly, none would suffer. But this is wholly impossible; human nature revolts against it; the interests of mankind are arrayed against such a proceeding. The profits and, therefore, the temptation of smuggling are so great, that all men become smugglers. The instincts of men are so powerful in that direction, that no law or danger can restrain them, and the trade, instead of being legitimate, merely assumes the form of smuggling. So it was in Spain, and so it continues to the present day. The chief trade of Spain is smuggling, and the greatest smugglers are the officers of the government, and the most powerful men; and while the cotton goods of England were absolutely prohibited from being brought into the kingdom, they were notoriously sold in Madrid at about 30 per cent. dearer than in Manchester itself.

127. In England the currency is more abundant in proportion to the services it can command, than in continental countries, so that the same evil consequences would be manifested here, unless there were means taken to counteract them. And this is done by diminishing the cost of production by the use of machinery. Powerful machinery

produces the effects of thousands of men at an inappreciably small cost. Hence, this machinery will produce as much wealth as many thousands of men, and this reduces the actual cost of production of any given quantity so much, that we can sell the commodities at a much lower price than any other nation. It is often remarked how prolific the year 1769 was of great men; towering above all, are enumerated Napoleon and his great antagonist Wellington; but another great antagonist of Napoleon came into existence that year, whose name deserves to be ranked with the most eminent of his vanquishers, and that is the SPINNING JENNY. It was not the quantity of gold and silver currency in the country that carried England through the last war, but the exhaustless powers of her machinery. It was James Watt and the ceaseless whirr of the Manchester mills, that produced the navies which swept the flag of her enemies from the ocean; and when the thunder-clouds of war gathered over her from all quarters of the horizon, enabled her to equip and send forth the armies of Wellington, to conduct away the tempest to spend its violence on a foreign land. It was this inexhaustible wealth-producing power, that saved the inhabitants of Britain from feeling the bitterness and horror of an Austerlitz or a Jena, in their own homes, when

“Europe at large was a province of Gaul.”

CHAPTER II.

THE THEORY OF PRICES.

"The Theory of Prices, and their variations, is the darkest part of our system."

"A statist does nothing for philosophical economy, unless he ascertains and describes *changes*, and such relations among his details as are matter of fact."

Life of FRANCIS HORNER. p. 154-5. (Chambers' Edit.)

"Ex omnimodâ experienciâ primum inventio causarum et axiomatum verorum elicienda est; et lucifera experimenta non fructifera quærenda. Axiomata autem recte inventa et constituta praxin non strictim, sed confertim instruunt, et operum agmina ac turmas post se trahunt."

BACON. *Nov. Org.* Lib. I. Aphor. LXX.

"All truth and all error lies in propositions."

J. S. MILL, *System of Logic*. 4th Edit. p. 18.

THEORY OF PRICES.

PRELIMINARY CONSIDERATIONS.

1. In the preceding Chapter, we have endeavoured to ascertain the meanings which should be affixed to the terms employed in Political Economy. Following the usual course of scientific inquiry, our next endeavour is, if possible, to discover some general expression which indicates the causes which govern the exchangeable relations of these quantities, or their changes of value. The value of every quantity with regard to every other being, as we have shewn in the preceding chapter, the respective quantities in which they can be exchanged at any given instant. It is never, however, the custom in civilized countries to consider the values, or the exchangeable relations of quantities with respect to each other directly, but always in reference to some given commodity, named money. The value in money of a commodity is called its price. The object, therefore, of our present inquiry is to discover the causes which influence prices, or a change of price. If we can discover some general form of expression which is applicable to all cases, at all times, and in all places, then the science we are considering takes rank as an Inductive Science. But if it be impossible to discover any such form of expression, and

if each separate case is influenced by its own peculiar causes, then it is not an Inductive Science. We shall endeavour to shew that the former is the case, and that a general form of expression may be found, which is universally applicable.

2. We have already observed, that the quantity of the currency that is given for any service receives different names according to the nature of the service. If the entire property of the thing purchased pass from the seller to the buyer, it is called its *price*; though in the case of debts, it is usual to speak of the *discount*, or the difference between the debt and its price. If the service consists only of the temporary use of anything, it receives different names according to the nature of the service. For personal services, it is called *wages*, *salary*, *pay*, or *fees*; for the use of property, *rent*, or *hire*; and for the use of money, *interest*. In all these cases we shall endeavour to shew that the quantity of money given for the service rendered is determined by the intensity of the service rendered, together with the comparative power of the person who renders the service over the one who purchases it.

3. We have hitherto spoken of the exchangeable value, or simply, the value of an article. This expression, as generally understood, denotes the value of an article, sold by competition in the public market. It is also frequently called the *market value*. But it is clear that this expression will not include all cases where a sale takes place. Many transactions take place, in which it is impossible to discover what the market value is. In fact, unless all commodities are brought into one focus, and all the purchasers come there to bid, it is scarcely possible to fix the market value of anything. Now, as our object is to discover a rule which shall determine the actual cause of price, whenever a real transaction takes place, we are not concerned to consider what it might have been under other circumstances, but we require some more general name for the value, or the price given for the purchase of a service, in every transaction between buyer and seller.

4. To shew how many transactions take place without its being possible to define what the market value is, we have only to consider the number of private sales that occur. A person may have a horse, or a picture, or a house, which he may wish to sell, and yet he may be very unwilling to put it up to public sale, and so he may offer it about privately, and he may get several offers, all different, and who shall say whether any, or which of these, is the market value? The same quality of article may be offered for sale in several shops, and the price different in each, which of them can be said to be the market value? Again, it may often happen that the market value is merely nominal, and that no purchaser can be found to give the price quoted in the public lists; as often happens in the very extensive description of property consisting of shares of all sorts, Bank, Railway, Insurance, and other public companies. These are generally quoted as being worth a certain price in the market, and yet their value may be only nominal, as it may happen that no one will buy them, so that it is impossible to obtain the money for them which they are reputed to be worth. But the holder of such shares, as well as of all other property, is frequently obliged by circumstances to part with them for what he can get, as in cases of bankruptcy, &c., when it is necessary to force a sale. Now, if we wish to obtain a general rule of any use, it must comprehend all cases of whatever description, in which a sale is effected. Consequently, what we want, is a name which shall universally express the price given for an article at the instant of the purchase. Sales may be either public, or private, voluntary or forced; and we require a name that shall indicate the value of the commodity at the instant, and under the circumstances of any one of these cases.

5. There is a term in astronomy, which aptly expresses the idea we require, and which we may fairly borrow for our purpose. Theoretically speaking, the path of a planet round the sun is an ellipse, and if there were but a single planet not acted upon by any disturbing forces, this would

simultaneously in its path. But, instead of one, there are a great number having simultaneously in their own paths, and they all act upon each other as disturbing forces, so that each body one of their trajectories. It is found that, namely, a planet moves in an ellipse, viz. the position of this ellipse is constantly changing, owing to the mutually disturbing forces. In this is never moves in the same ellipse for two consecutive periods of time, and the calculation has to be made not for its position in the theoretical path, but for the ellipse it will be in at the instant required, and this is called the *Instantaneous Ellipse*. Now, the prices of a great number of articles, especially those of general consumption, and several other descriptions of property, vary from day to day, and from hour to hour, from a multitude of causes which cannot be foreseen or controlled, and the price in each separate case, when a transaction takes place, is determined by the relative positions of the buyer and seller at that particular instant, and not by what its value might have been, under other circumstances. Hence, we may fairly call the price actually paid in any transaction, the *INSTANTANEOUS VALUE*, and this name is of a far more general nature than the other two, and will include them.

6. When a great amount of power is contained in a small space, the effect produced by that power is said to be very *intense*. Thus, if a great quantity of light proceeds from a small luminous surface, it is called an intense light; so, also, we speak of an intense heat, or an intense pain, intense excitement, &c.; and in a general way, when we speak of different degrees of power in a given space, we measure them by their relative intensity.

7. We may, in a similar manner, speak of services of different degrees of intensity, according to the circumstances under which they are done. The very same thing may be of far more use at one time than at another, and hence, from the analogy of the cases, we may call it a service of greater or lesser intensity. Thus, if a man who had just eaten a sumptuous dinner, were offered a crust

of bread, and a cup of cold water, they might, being presented at such an unseasonable time, excite in him a feeling bordering upon disgust. But, if the same man were left alone upon a desert island, in the last gasp of starvation, or in a caravan among the sands of Africa, overwhelmed with heat and thirst, with what different feelings would he receive the same food! Under such circumstances, a person who had such things to dispose of, might almost extract from the sufferer any price that he was able to give. In these two cases, the act done was precisely the same. But the *value* of the act, or the desire of the person who received it, to have it done, and the sum he would give to have it done, was very different, and we may call the service done in the latter case, one of much greater intensity than in the former.

8. Or we may suppose a vessel to founder, at some distance from the land, leaving only a small portion of the mast above water, to which a passenger might cling. If a boatman were to row off to him from the shore, he might extract any price he could give, to save his life. Now, the fact of rowing a man a mile or so, in a boat, would be no great thing, taken by itself, but under the circumstances of such a case, it would be of very great value, and so it would become a service of great intensity. If only one boatman came off to save the drowning man, not only would the service be one of great intensity, but he would be absolutely in the power of the boatman, and must yield to his terms, however cruel or exorbitant they might be. But if two or more boatmen, instead of one, came off, they would probably bid against each other, and the price be reduced, because they would be eager to gain, by rendering the service. The service, however, to the drowning man, would be of the same intensity, whoever did it, though he would be less in the power of any one boatman, if there were several competitors to render it. Now, the effect of the intensity of the service rendered, would be to raise the price of the service, and the effect of the one

boatman having complete power over the drowning man, would be to raise it still more; but, on the contrary, the effect of there being two or more competitors to do the service, would be to diminish the power of any one of them over the purchaser of it, and would consequently diminish the price. The price of every service rendered consists of these two elements, viz., the intrinsic value, or the intensity of the service itself, which we may also express by the necessity of the person who requires it, and the power of the person who renders it, over the one who receives it; or we may say that the price varies, as the intensity of the service rendered, and the power of the seller.

9. We may express this in rather a neater form. If the price increases according to the power of the seller, it must diminish according to the power of the buyer. Now, prices are a continual contest between buyer and seller, and these are the weapons with which the respective parties are armed; on the one side, the intensity of the service to be rendered, or the necessity of the person who requires it, on the other, the power of the person who wants it to choose among a greater or less number of competitors to render it. These are the two elements which, in their ceaseless conflict, determine the price at the point where they meet and neutralize each other; and as one prevails over the other, the price advances or recedes, as the foam at the meeting of opposing tides is borne backwards or forwards, according to the varying force of each.

10. The rule, then, which determines price, may be expressed in this way—

Price varies directly as the intensity of the service rendered, and inversely as the power of the buyer over the seller.

This expression, properly interpreted, will be found to be of universal application, and to comprehend all transactions of whatever nature they be, whether by way of prices, or absolute purchase, or wages, or rent, or interest.

11. This law obtained by the most rigorous induction from feigned cases which are possible, and therefore to be admitted in philosophy—cases which are the *lucifera experimenta*, so earnestly insisted upon by Bacon, for the purpose of discovering general principles,—is that great general law, which universally governs the exchangeable relations of quantities, of which we were in search. It is an example of what is called the *law of continuity* in the Inductive Philosophy, because, as we have shown that the law is true at both the extremes of prices, it must also be necessarily true at all the intermediate points. For that which is true at the extremes, is true at the means. We shall now proceed to shew its application in Political Economy, and examine some other rules, which have been proposed by other writers on the subject. For the sake of convenience, we shall consider the application in two sections.

I. When the absolute property of the quantity passes from the vendor to the purchaser—where there is an actual change of ownership—that is, cases of SALE.

II. Where the purchaser only acquires the right to the temporary use of the quantity, or the right of possession for a limited period, but there is no change of ownership, and the property of the quantity remains with the seller of the service, and the possession of it reverts to him, after the expiry of this limited period.

One advantage of this method of treating the subject is, that it groups together, and keeps in juxtaposition, subjects such as rent, and interest, which are in their nature exactly analogous, but which are too often separated, and their natural connection severed, in treatises on Political Economy.

SECTION I.

ON THE APPLICATION OF THE LAW OF PRICE TO
CASES OF ABSOLUTE SALE.

1. The formula which we arrived at in Section 10, is manifestly only another form of the expression, that value depends upon the relation between supply and demand. It, therefore, asserts that price is in all cases governed by the relation of demand and supply. If, therefore, we were now laying down the science for the first time in a positive form, we should at once proceed in the usual manner, having obtained this law inductively, to apply it deductively to the explanation of phenonema. But unfortunately another law has been devised by the best known writers on Political Economy, and has been extensively received. It is this, that *cost of production regulates value*. It is, however, nothing but an utter and mischievous fallacy, totally subversive of the science of Political Economy. We must, therefore, demonstrate its fallacy, and also complete the proof on the principles of the Inductive Philosophy, by showing that the cases which are apparently accounted for by the false law, are all in reality only particular cases, or examples of the true law. We shall show, as is indispensably necessary to make good our assertion, that the law we have obtained is of universal application, that it absorbs not only all the cases which appear to be ex-

plained by the false law, but also all other cases which the false law does not even pretend to account for.

2. Adam Smith and Ricardo, who are the original writers in this country who have hitherto exercised the greatest influence over opinion in these subjects, saw the necessity of endeavouring to arrive at some general rule expressing the cause which governed value. Adam Smith founded all his ideas of value upon labor. Thus, he says "Labor, therefore, is the real measure of the exchangeable value of all commodities. The real price of everything, what everything really costs to the man who wants to acquire it, is the toil and trouble of acquiring it. What everything is really worth to the man who has acquired it, and who wants to dispose of it, or exchange it for something else, is the toil and trouble which it can save to himself, and which it can impose on other people." "Equal quantities of labor, at all times and places, may be said to be of equal value to the laborer." "Labor alone, therefore, never varying in its own value, is alone the ultimate and real standard by which the value of all commodities can, at all times and places, be estimated and compared. It is their real price, money is their nominal price only." "Labor, therefore, it appears evidently, is the only universal, as well as the only accurate measure of value, or the only standard by which we can compare the values of different commodities at all times and all places."*

The fundamental principle of Adam Smith's system of Political Economy is, that *labor is the measure of value*, and that equal quantities of labor are always of equal value.

3. The least reflection will show how utterly and entirely fallacious this measure of value is. If it were true, it would follow that every object was valuable exactly in proportion to the labor bestowed upon producing it. Consequently, if we were to sink a well to a great depth,

* Wealth of Nations, Book 1. Chap. 5.

the pebbles and rubbish brought up from the bottom of it, ought to have an enormous value, but a diamond picked up on the surface of the ground, should have no value. By a parity of reasoning, the same product ought to have the same value in all places where an equal quantity of labor had been bestowed in producing it. But these ideas have been elaborately refuted in the previous chapter, where we have endeavoured to establish it as the fundamental principle of Political Economy, that it is not labor that confers value, but value that attracts labor; and that all value is local. We have already so fully shown that value springs entirely from the desires of others, and that no amount of labor can confer value on any product if it is not wanted, that we need not spend any more time in refuting this error.

4. But Adam Smith's work is unfortunately wholly destitute of that singleness and simplicity of conception which is indispensably requisite in a scientific treatise. He has involved himself in inextricable perplexity by adopting *two* distinct measures of value. First, the quantity of labor bestowed upon producing an article; secondly, the quantity of things it will exchange for. Ricardo clearly perceived this inconsistency, and justly censured him for it; "Adam Smith, who so accurately defined the original source of exchangeable value, and who was bound in consistency to maintain that all things became more or less valuable in proportion as more or less labor was bestowed upon their production, has himself erected another standard measure of value, and speaks of things being more or less valuable in proportion as they will exchange for more or less of this standard measure. Sometimes he speaks of corn, at other times of labor, as a standard measure, not the quantity of labor bestowed on the production of any object, but the quantity which it can command in the market, as if these were two equivalent expressions, and as if because a man's labor had become doubly efficient, and he could, therefore, produce twice the quantity of a commodity, he would necessarily receive twice the former quantity in exchange for it.

If this, indeed, were true, if the reward of the laborer were always in proportion to what he produced, the quantity of labor bestowed on a commodity, and the quantity of labor which that commodity would purchase, would be equal, and either might accurately measure the variation of other things; but they are not equal, the first is under many circumstances an invariable standard, indicating correctly the variation of other things; the latter is subject to as many fluctuations as the commodities compared with it.”*

5. Ricardo, therefore, condemns and rejects Adam Smith's idea, that as labor may sometimes purchase a greater and sometimes a smaller quantity of goods, it is their value which varies, not that of the labor which purchases them, “and also that labor alone, never varying in its own value, is alone the ultimate and real standard by which the value of all commodities can, at all times and places, be estimated and compared.” But he adopts what Adam Smith has also said, “That the proportion between the quantities of labor necessary for acquiring different objects, seems to be the only circumstance which can afford any rule for exchanging them for one another.” Or as Ricardo expresses it, “That it is the comparative quantity of commodities which labor will produce, that determines their present or past relative value, and not the comparative quantities of commodities which are given to the laborer in exchange for his labor.”†

6. Ricardo, then, adopts labor as the foundation of all value, and that the relative values of commodities will be governed by the relative quantities of labor bestowed upon their production.‡ As a necessary consequence he says that, that commodity only can be invariable in value which at all times requires the same sacrifice of toil and labor to produce it.§ He very justly says that no such commodity exists, because it is impossible to

* The Principles of Political Economy and Taxation. 3rd Edit., p. 5.

† Do. p. 9. ‡ Do. p. 46. § Do. p. 323.

maintain the conditions of production always uniform. But it is quite possible to agree and speak about it, as if such a one did exist. He also says that though Gold by no means accurately conforms to this principle, it does so more nearly than any other commodity, and is therefore the best material of which to make a measure of value. He rejects the idea of estimating the value of commodities by the abundance of other commodities they will exchange for.*

7. The Law then proposed by Ricardo, and which is the fundamental principle of his system of Political Economy, is that *Cost of Production regulates Value*. Thus, speaking of corn, he said † that the cost of production did not the less vary, and that must regulate price; and again, "no principle was more true than that the cost of production was the regulator of value."

8. Ricardo, however, admits that this rule is not applicable to all commodities. Thus, he says, "There are some commodities, the value of which is determined by their scarcity alone. No labor can increase the quantity of such goods, and therefore their value cannot be lowered by an increased supply. Some rare statues and pictures, scarce books and coins, wines of a peculiar quality, which can be made only from grapes grown on a particular soil, of which there is a very limited quantity, are all of this description. Their value is wholly independent of the quantity of labor originally necessary to produce them, and varies with the varying wealth and inclinations of those who are desirous to possess them."

"These commodities, however, form a very small part of the mass of commodities daily exchanged in the market. By far the greatest part of these goods which are the objects of desire, are produced by labor, and they may be multiplied not in one country alone, but in many, almost without any assignable limit, if we are disposed to bestow the labor necessary to obtain them."

* The Principles of Political Economy and Taxation. 3rd Edit. p. 333.

† Hansard Parl. Debs. New series, Vol. VII. p. 949.

"In speaking, then, of commodities, of their exchangeable value, and of the laws which regulate their relative prices, we mean always *such commodities only, as can be increased in quantity by the exertion of human industry, and on the production of which competition operates without restraint.*"*

9. To this we reply that the exclusion of the classes of articles, which are not the subject of unlimited production and competition, from the terms of a general rule, cannot for a moment be permitted by any one who understands what Inductive Philosophy is. To limit the scientific rules of Political Economy to certain classes of cases alone, is just as erroneous as to limit the science of Astronomy to certain phenomena, which can be accounted for only by some particular hypothesis, such as the Ptolemaic; or to limit the science of Optics to those phenomena alone, which can be accounted for on the corpuscular theory of light; and so on of other cases. But such ideas cannot be tolerated at the present day. How earnestly does Bacon over and over again inculcate that the negative cases are more powerful than the positive ones, and to take heed that we verify our general rules, by applying them to ALL cases, lest peradventure the little David be forgotten. Never was there a more bold defiance and contravention of all the well established laws of modern science than Ricardo's idea. But it must be inexorably rejected. Nothing less will satisfy the requirements of science, than an expression which includes all cases without any exception.

10. The law laid down by Ricardo is so palpably fallacious and incomplete, that those even who most strenuously admire him have been compelled to qualify it. Thus, Mr. J. S. Mill, in summing up the causes which regulate value, says: "Demand and supply govern the value of all things which cannot be indefinitely increased; except that even for them, when produced by industry,

* Principles of Political Economy and Taxation, p. 3.

there is a minimum value, determined by the cost of production. But in all things which admit of an indefinite multiplication, demand and supply only determine the perturbations of value, during a period which cannot exceed the length of time necessary for altering the supply." But this conclusion is, if possible, worse than Ricardo's. Ricardo boldly put out of sight what did not square with his rule. But Mr. Mill does exactly what those would do in Astronomy, who made a system, and said that some phenomena were to be explained on the Theory of Ptolemy, and other phenomena on the Theory of Copernicus and Newton. Or who said that, in Optics, some phenomena were to be accounted for on the corpuscular theory, and other phenomena on the undulatory theory. What should we think of such doctrines at the present day?

11. It is perfectly evident that Ricardo's rule, that cost of production regulates value, is amenable to exactly the same censure, which he has so justly visited upon Adam Smith's rule, that labor is the measure of value. The true use of science is to point out to us the true causes that influence events, and to show how we are to act in order to produce a required effect. Most truly does Bacon lay it down as one of the first canons of his Philosophy: "That which in Theory is the cause, in Practice is the Rule."* The meaning and the application of this canon to the present question is obvious. Ricardo instinctively applied it to Adam Smith's rule, and he must be judged himself by the same law. Now, if Ricardo's rule be true, it means that, if we want to change the value of a commodity we have only *to change the cost of its production*. If it were true, it would necessarily imply that a perseverance in producing any article at a great expense, if continued long enough, would in the end succeed in raising its value. Now, this doctrine is notoriously absurd, because if an article is produced in greater quantities than

* Nov. Org. Lib. 1. Aph. 3.

required, its value will infallibly fall, and we shall shew hereafter, that in many cases while the cost of production increases, the value of an article may diminish.

12. The importance of this doctrine demands the utmost attention, for an erroneous conception of the source of value is one of the cardinal errors of Adam Smith, and is the very foundation of the Protectionist system of Political Economy, which so long afflicted this country, and which still impoverishes nearly every nation on the continent. And in this he has been followed by Ricardo. These two writers maintain that there are two different species of price, one the *natural* price, and the other the *market* price. Adam Smith says: * "When the price of any commodity is neither more or less than what is sufficient to pay the rent of the land, the wages of labor, and the profits of the stock employed in raising, preparing, and bringing it to the market, according to their *natural* rates, the commodity is then sold for what may be called its *natural* price." The apparent good sense, clearness, and precision of this sentence might, perhaps, entrap an unwary thinker into giving it a ready assent. No sooner, however, do we come to analyse it, than we find that it would be difficult for so few lines of so plausible a sound, to contain a greater amount of vagueness and inaccuracy, and when we endeavour to extract some tangible meaning from it, it vanishes away into nothing. What is the *natural* rent of land? What are the *natural* wages of labor? What is the *natural* cost of raising, preparing, or bringing it to market? One producer may be more skilful and industrious than another, or may discover more economical methods of producing than his neighbours, and these differences may exist in a great variety of degrees. Which of these are the *natural* rates? Does the natural value differ in every case? Let us take the example of wheat. Wheat is grown in one county where wages are 14s. a week, in another where they are 10s., in another

* Wealth of Nations. Book I. Chap. 7.

where they are 7s., in other parts of the world where it is raised by the labor of serfs. Rent may be 30s. an acre in one county, 20s. in another, and 15s. in another. Which of these is the *natural* rent? The cost of transport from one county may be 2s. a quarter, from another 5s., from another 10s. Quantities of wheat produced under all these varying circumstances, mingle in the same market, and it never happens that each separate parcel of wheat is sold according to what Adam Smith would call its *natural* price. On the contrary, is it not notorious that wheat of the same quality will sell at the same price, in the same market, at the same time, whether it comes from Essex or Peru? Whether it be produced at an expense of 25s. a quarter, or 2s.? No consideration whatever influences the price in the market, but that of demand and supply. If a small quantity of wheat, produced at a very low price, be brought into the market, its value will immediately conform to the ruling market price; if a large quantity be thrown on the market, its effect will be to depress the value of the whole quantity in the market—no matter what might have been its cost of production; and in all these cases simply according to the rate of alteration it produces in the relation between demand and supply. On the news of the declaration of war being received in a peaceful market, the price flies up immediately, because it is apprehended that war will cut off the sources of supply, and cause a scarcity. On the other hand, if in the midst of war, the news comes that the arch enemy is no more, the price immediately falls, because it is expected that peace will again open the flood-gates of abundance. Now, these, and whatever other causes act upon the price of wheat, do so simply through the prospective changes in the relation of supply and demand that they are expected to produce, and without the smallest reference to the cost of production.

13. The systems, both of Adam Smith and Ricardo, although there may appear to be a difference between them, are, nevertheless, identical in their fundamental

error, for they look to the wrong person as conferring value on any article. They both look to the *producer* as conferring value on the article, whereas it is unquestionably certain that it is the *consumer* who bestows value. Adam Smith says, that it is the labor which the producer bestows upon the article that gives it its value, whereas it is perfectly indisputable, that things have not value *because* labor is bestowed upon producing them, but much labor is bestowed upon producing them because people desire them very much, and will give a great price for them, and, therefore, they have a great value. Ricardo says, that cost of production regulates value. But it is indisputably true, that things are not valuable because they are produced at a great expense, but people spend much money in producing because they expect that others will give a great price to obtain them; that is, the things will be of great value when produced. Buyers do not give high prices because sellers have spent much money in producing, but sellers spend much money in producing because they hope to find buyers who will give more.

14. The universal law in Political Economy is, therefore, that THE RELATION BETWEEN DEMAND AND SUPPLY IS THE SOLE REGULATOR OF VALUE. This law, like the law of gravity, holds good in all cases whatever. It not only governs the value of any article, but also governs the value of every separate item of which that article is composed. All circumstances whatever that influence value, can be shewn to do so solely through their effect in altering the relation of supply and demand.

15. Price, then, is a perpetual struggle between the buyer and the seller, and the circumstances which compel one party to yield, are the only measure of value at the time of the purchase. To say that the cost of production regulates price is only true in this sense, that no man would willingly sell any article he had produced at a less price than that, together with something additional, by way of reward for his own labor, and he could not

continue do so for any length of time; but having settled that in his own mind as the lowest limit, he always endeavours to get as much more as he can, without the smallest reference to the cost of production, and how much more he can get is determined by the rule we have given above, namely, by the necessity the purchaser has for that particular service, together with the number of competitors to render it; on the other hand the purchaser cares nothing for the cost of production, his only object is to buy as cheap as he can, and he takes no thought whether the seller is selling at a loss or not. The result of this will be that if the selling value of any article falls below its cost of production, for a length of time, it will cease to be produced. Every man endeavours to produce as cheap as he can, and to sell as dear as he can, and the two operations are quite independent of each other.

16. When we say that the relation between supply and demand is the sole regulator of value, we mean to say that a change of value depends solely upon a change in that relation and upon nothing else. No change in the cost of production will make any change in value, unless it is also accompanied by a change in the relation of demand and supply, and it is only through and by means of causing such an alteration, that a change in the cost of production is usually accompanied by a change in value.

17. In order to illustrate this, let us take a few examples; let us take any article, such as stockings, and let us suppose that at any given time they bear a certain price in the market, no matter what, and that there is a certain demand for them at that price.

Let us suppose that at a certain time before the introduction of machinery, a manufacturer employed 1,000 hands; let us also suppose that he at some time invents a piece of machinery by which he can produce the same quantity of stockings, but at the same expense as 50 men would be. Now, if he only produces the same quantity

as before, as he will of course take the best price he can get for them, the demand remaining the same, it is quite evident that no alteration in price will ensue, and all the profit accruing from this diminution in the cost of production will go into the pocket of the producer; consequently, if he does not manufacture any additional quantity, no alteration in the market price will follow, everything will go on as before; the only difference will be that that particular manufacturer will make enormous profits, owing to his sagacity and skill in inventing this machinery. But if the materials for making the stockings can be supplied in unlimited quantities, the manufacturer will naturally wish to increase the quantity he produces, and realize greater profits; but if he produce a greater quantity than before, that increased quantity will not be sold, unless offered at a diminished price, so as to increase the circle of buyers; but as the cost of their production has been diminished to him, he can afford to sell at a diminished price, and the more he wishes to sell the more must the price be reduced. Now, it is quite evident that the increased quantity of this single manufacturer thrown upon the market, and offered at a diminished price, will affect the prices of the whole quantity in the market, because every one else must consent to sell at the same price to effect a sale at all. It is also clear that every single manufacturer must accommodate his prices to the market price, and if he cannot produce at the market price he will have to cease producing; and as we may suppose that there are several degrees of skilfulness and economy among the various manufacturers, it is quite evident that at every successive diminution of the market price, those in succession will have to cease working who are least able to produce cheaply. Hence, it is quite clear that it is the market price which regulates the quantity of expense that can be afforded in producing, and that it is the quantity that can be produced at the least expense, compared to the whole quantity that can be sold, that regulates the market price.

Hence, also, we see the utter fallacy of Ricardo's rule, which will be more particularly alluded to in the next section, that it is the cost of production under the most unfavorable circumstances that regulates price. The truth is that it is the exact reverse. The price regulates the greatest cost of production that can be afforded, or the most unfavorable circumstances under which production can take place.

18. Let us further illustrate this by the example of corn, because Ricardo's Theory of Rent is one of the principal things upon which his reputation rests. Ricardo supposes that when a country is first settled that the best and most fertile land is first cultivated, and as population increases cultivation gradually extends to lands of inferior quality, and more distantly situated from the growing markets, to which the cost of transport constantly increases as the distance increases. This supposition is perfectly legitimate. Now, the cost of production to the cultivator who wishes to sell his corn, is the cost of placing it in any required market; and it is quite clear that combining all the circumstances of production in different cases, there is a regular series of gradations of cost of production of corn in different localities. Hence, the profits, or the difference between the cost of placing the corn in any given market, and the sum actually received for it, must also vary in a regular series of gradations till they diminish to nothing. That is, the inducement the cultivator has for sending his produce to market will ultimately vanish, and no corn can be produced, *i. e.*, sent to market, under more unfavorable circumstances than this vanishing point.

19. Now, let us suppose that there is a certain market, which is supplied with corn, produced under these various degrees of cost of production, so that the last quantity supplied only just leaves sufficient profit to induce the cultivator to send the corn to market. Then Ricardo asserts, that it is the corn produced under the most unfavorable circumstances, that regulates the

market price.* It is quite clear that it is exactly the reverse, it is the market price of corn which indicates the most unfavourable circumstances, *i. e.*, the greatest expense under which it can be produced.

20. Suppose that, while a great number of cultivators send their corn to market, one of them acquires greater skill, or devises some machinery for cheapening cultivation, or discovers some manure that increases the quantity produced, then if he sends no more to market than he did before, no alteration of the market price will take place, and the extra profits arising from the diminution of the cost of production, will go into the pocket of the producer. And so on, of any number of cultivators, who can diminish their cost of production, if they do not increase the quantity sent. But if an increased quantity be sent, it must be offered at a reduced price, in order to cause an additional sale. That reduction of price will annihilate the profits upon the last quantity produced, and corn will cease to be produced under such circumstances. Or if we suppose a quantity introduced from a foreign country, that quantity will lower the price in the market, and annihilate the profits of those quantities produced under the most unfavorable circumstances, and that, just in proportion to the additional quantity offered for sale. And as more is imported, those quantities produced in the increasing scale of unfavorable circumstances will successively cease to be produced. Again, if the foreign importations are diminished, the market price will correspondingly rise, and cultivation may be gradually resumed under increasingly unfavorable circumstances. Hence, we see, that it is always the ratio of supply and demand that regulates market price, and the market price which regulates the greatest amount that can be afforded as cost of production, or indicates the most unfavorable circumstances under which production will take place.

* Principles of Economy and Taxation. p. 60-1. 3rd Edit.

21. During the great revolutionary war, a succession of bad harvests, joined to other causes, produced an enormous rise in the price of corn, so that in 1812 it reached the price of 130s. a quarter. Owing to this extraordinary rise of price, an immense quantity of inferior land was taken into cultivation at an extravagant cost, because the farmers expected that high prices would be permanent. Now, let us suppose that the old lands in cultivation had produced no more than they had done during the years of scarcity, what would have been the necessary consequence of this additional quantity of corn added to the market? As the quantity of land taken into cultivation could only be increased gradually, the first quantity added to the existing supply would not have added much to it. The proportion between the increment and the existing supply would not have been great, consequently it would only lower prices a little, and would leave a large profit to the producer. But the more land that was brought into cultivation, the more would the quantity of corn brought to market be, and the more would prices be lowered. And this might go on until the constantly increasing quantities of corn lowered the price so much, that it would only just leave a profit, and further production would cease. And it is perfectly evident, that it would always be the market price which would indicate how great an expense could be afforded as cost of production. Hence, we see, that it was the increased price of corn that called inferior land into cultivation, and it was the increased quantity of corn produced, that lowered the market price, until the cost of production and the market price might possibly meet. But whether they did so or not, would entirely depend upon the quantity produced.

22. Exactly the same principle holds good with regard to mines. The cost of production of all minerals may vary in a regular series, and at any particular time it is the market price which regulates the most unfavorable circumstances under which production will take place.

Thus, in the case of Gold mines, we may legitimately presume that there were some mines worked, which only just paid their expenses. Now, when the amazing abundance of the gold fields of California and Australia began to produce their effects in that district, by a rise in the price of wages and commodities, it is evident that the least productive mines would have to be abandoned in succession. Consequently it would be the market value of gold, which would regulate the most unfavorable circumstances under which gold would be produced. The same is true of any other minerals, such as coals. And from the case of coal mines, we may draw an example which shews the entire fallacy of the Ricardian doctrine, that cost of production regulates value. Nothing is more common in coal mines, than to have the different strata of coals, which are comparatively speaking quite close to each other, of entirely different qualities, and suited to totally different purposes. Yet the cost of working each of them may be exactly the same. Now, it is manifest that the better qualities of coal will command a better price in the market than the inferior qualities, and yet their cost of production is the same. That is, with the same cost of production their values are different. What then becomes of the Ricardian doctrine, that cost of production regulates value? Is it not seen to be a pure fallacy? On the contrary, as we have shewn, it is the result, and that alone that has value, and what that value is depends purely on the supply and demand, and is quite independent of the cost of production.

23. Hence, we see how utterly fallacious is Ricardo's doctrine; "*When land of an inferior quality is taken into cultivation, the exchangeable value of raw produce will rise, because more labor is required to produce it.*"* What confusion of language and idea! It is perfectly clear that the subjects connected in this paragraph, should have been arranged, thus,—"*When the exchangeable*

* Principles of Political Economy and Taxation. p. 60.

value of raw produce rises, land of an inferior quality will be taken into cultivation, because more labor may be profitably employed in producing it."

So, also, how utterly fallacious is the following!—"The exchangeable value of all commodities, whether they be manufactured, or the produce of the mines, or the produce of land, is always regulated, not by the less quantity of labor that will suffice for their production under circumstances highly favorable, and exclusively enjoyed by those who have peculiar facilities of production, but by the greater quantity of labor necessarily bestowed on their production by those who have no such facilities, by those who continue to produce them under the most unfavorable circumstances; meaning by the most unfavorable circumstances, the most unfavorable under which the quantity of produce required, renders it necessary to carry on the production."

A consideration of the preceding cases, shews that it is exactly the contrary of what Ricardo asserts. It is in all cases whatever, in the produce of manufactures, mines, and land, the market price, and that alone which indicates the most unfavorable circumstances under which production can take place. The market price purely depends upon the relation of supply and demand, and is wholly independent of the cost of production. And it is the quantity produced under the most favorable circumstances compared to the whole quantity for which purchasers can be found to give a certain price, that regulates the supply or the quantity that will be produced.

24. Now, this is no immaterial dispute about words, it is not mere logomachy, but it is a fundamental difference of principle between two distinct systems of Political Economy. What we say is, that Ricardo has plainly inverted cause and effect. That his views and principles are as entirely fallacious as if he had composed a treatise on heat, and laid it down as a fundamental principle, that it was the rise of the mercury in the thermometer that regulates the heat of the atmosphere, or that the rise

of the mercury in the barometer *caused* fine weather. And those who admire Ricardo's principles of Political Economy, ought in consistency to maintain the two latter propositions.

25. It is so extremely important to understand the nature of the fallacy which runs through the whole of the Ricardian system of Political Economy, that we may give another illustration. It is well known that the cultivation of certain agricultural products, and the climate they can flourish in, are intimately connected. At certain points the cultivation of maize, the vine, olives, the palm, ceases, and it is possible to ascertain by experience the average temperature of the country in which these things occur. Now, reasoning exactly as Ricardo does, we ought to say, that the boundaries of the cultivation of these products *regulated* the climate of that place, when it is manifestly the reverse, it is the climate that *regulates* their production. The cultivation of a certain vegetable may *indicate* the climate, but it does not *regulate* it any more than the speed of the paddle wheels regulates the motion of the engines. The whole of Ricardo's palpable fallacy is based upon a misconception of the meaning of *to regulate*.

26. It is perfectly true that in a great many, nay, the majority of cases, the natural effects of competition will cause the price to approach very nearly to the cost of production, and Ricardo's rule will *apparently* be found to answer. But this is just one of the things which must be most sedulously guarded against in science, viz., to give in a careless adherence to a form of expression which is radically erroneous, because it *appears* to account for phenomena. We will give an exact parallel. In the olden times philosophers thought that the motion of projected bodies had a natural tendency to decay. They always saw that the motion of a body projected gradually diminished, and finally ceased. Now, it is quite easy to calculate results upon this principle. Given a certain velocity of projection, it would have been quite easy to calculate when the motion would cease, upon the supposition that it na-

turally decayed. And the results would have agreed with the calculation. What could be more satisfactory? If, then, it is hastily assumed that, because results may agree with calculation, the principles of those calculations are, therefore, *necessarily* true, those opinions might have maintained their ground. But it is well known that modern philosophers have entirely rejected such a notion, as that motion has a natural tendency to decay. But they arrive at the same result by a totally distinct principle. They say that motion has no natural tendency to decay, but that, in all the cases we see, there are counteracting principles, such as the resistance of the air, friction, &c., which oppose it, and finally destroy it. And they unanimously reject the former mode of accounting for the results, and adopt the latter. Hence, we see that though principles are manifestly erroneous, which do not account for results, yet it does not necessarily follow that any principle which does account for them, is, therefore, necessarily true, because, in fact, it may happen that several different principles may account for the result, and it requires judgment to decide which is the true one. Now, the Ricardian principle of value is just like the former of those of motion. It apparently accounts for results in a great many cases, and, therefore, may impose upon an unwary thinker. But it is a dangerous and seducing error, utterly false in principle, and to be repudiated and rejected by those who study Political Economy in the true spirit of science.

27. In a great number of cases it is impossible to say what the cost of production of any article is, and the very fact of a market being opened up for it, is the very thing that confers value on it. In the last century, eggs were at 1d. a dozen in the Highlands of Scotland, and salmon was so abundant, that it had scarcely any saleable value at all, there being no communication with the Southern markets. When this communication was opened eggs rose to 4d. or 6d. a dozen, and salmon acquired a value of about 1s. a pound. That was because agents from the South came and bought up the produce, because eggs

were, perhaps, 1s. 6d. a dozen in the London markets, and salmon was 2s. 6d. a pound. Now, eggs were not 1s. a dozen in London because they were 4d. a dozen in the Highlands, but people gave 4d. a dozen for them in the Highlands because they could get 1s. a dozen for them in London. What, then, becomes of the Ricardian rule, that cost of production regulates value? In this case it was the value of the eggs in the London market, that regulated their value in the Highlands, and not the reverse, and the same is obviously true of all other species of produce.

28. Again, let us observe what is the result of a diminution of the cost of production, according to various circumstances. The Northern counties of Scotland export corn and cattle to the Southern markets. They were served by a Steam Company, which had a monopoly of the trade. The usual consequences of a monopoly followed. Those which concern us here, as a question of Political Economy, were, that the freights and fares were most extravagant, and all petitions for reduction were unheeded, as the Company thought there was no danger of opposition. However, the people of the North could stand it no longer, and they determined to provide steam-boats of their own. The natural consequence immediately followed, freights and fares were reduced nearly one half. Almost all the farmers subscribed for shares in the steamer, and many of them told me that if they lost all the money sunk in the steamer, they would still be great gainers by the saving of freights. That is, the diminution in the cost of production (*i.e.*, the expense of placing their produce in the Southern markets,) went into their pockets. And why was this? Because the additional quantity of corn, &c., thrown by the Northern districts upon the Southern markets, was a mere drop in the bucket, compared to the demand of the Southern markets, and had no appreciable effect in lowering prices there, consequently, all the profits arising from the saving of freight, and the diminution of the cost of production, went into the pockets of the Northern farmers and landlords.

29. It is perfectly manifest that any diminution of the cost of production, through however large an extent of country it might cover, would have no effect whatever in altering the market price, until the extra quantity thrown upon the market bore an appreciable proportion to the previous supply. And if districts of country are excluded from markets, either by want of communication or by prohibitive laws, then, when there are markets opened to them, their produce will acquire an immensely increased value to what it had before. That is, the opening of the markets will immensely increase the value of the produce in the country, and the increased quantity of produce thrown upon the market, will tend to lower the value of the produce in that market, and these two values will approach to each other in the inverse proportion of the respective quantities, precisely as the space travelled through by each of two bodies under the influence of gravity, is in the inverse proportion of their masses. The establishment of steam navigation enormously increased the value of produce in the north of Scotland, the repeal of the corn laws enormously increased the value of produce in the Danubian principalities.

30. A consideration of the preceding examples will furnish us with the following rules:—

1. No change in the cost of production will cause a change in value, unless it is accompanied by a change in the relation of supply and demand.
2. A diminution in the cost of production, when effected without an increase of the quantity produced, goes entirely to the benefit of the producer.
3. A diminution in the cost of production, in cases where the quantity of the produce can be increased without limit, goes entirely to the benefit of the consumer.
4. A diminution in the cost of production, in cases

where the quantity is increased, but not without limit, goes partly to the benefit of the producer, and partly to the benefit of the consumer, and this benefit is divided between the two in the inverse proportion of the extra quantity added, compared to the previously existing consumption.

31. It is necessary to observe, that when we say that a change in price invariably depends upon a change in the relation of supply and demand, we by no means assert that the change in price is directly proportioned to a change in that relation, so that, for instance, an addition of one-fourth of the quantity, would produce a reduction of one fourth in price. It is well known that this proportion does not hold; and that a different proportion is found to obtain among different articles. Nor, though attempts have been made in some instances, such as corn, to discover the relation that exists between the two, does it appear that any satisfactory solution has been obtained. All that can be said is that it is a change in the one that produces a change in the other, without asserting that there is any fixed proportion between the two changes, because it may very well be, and we believe it to be the case, that that proportion follows no fixed law, but varies according to time and circumstances.

32. We shewed in Chap. I. Section 5, that in the earlier stages of society, before the introduction of a currency, there would be a natural tendency towards an equilibrium of advantages, in all cases where the production was open to general competition. Exactly the same thing takes place, when all values and profits are estimated in money. When the production of any article is open to general competition, there will be the same inevitable tendency to an equality of profits. The profits being measured by the difference between the cost necessary to produce the article, and the price realized for it, if there be any article by which unusual profits can be realized, there will be a strong competition to produce that article, until the extra quantity so produced reduces the profits

to the level of other profits. That this is the case with the great majority of articles, is quite true, and, therefore, the generality of manufactured articles, and which can be produced, at nearly equal expense by different manufacturers, will have a tendency to keep pretty near that limit. But it must be carefully observed, that the change in price is universally caused by the change in the relation between supply and demand.

33. Hence, we may express the laws of the subject in this way :

1. THE RELATION BETWEEN DEMAND AND SUPPLY IS UNIVERSALLY THE ONLY REGULATOR OF VALUE.
2. *In such cases as production can be increased without limit, people learn to adjust the supply to the demand, so that the value of the article will nearly agree with its cost of production.*

34. No one who understands the principles of philosophical reasoning which are universally allowed to be conclusive in other sciences, and wishes to preserve that continuity of the sciences so earnestly insisted upon by Bacon, can fail to see that the preceding considerations are absolutely conclusive as to the fundamental error of the Ricardian system of Political Economy. If it be possible to obtain a general philosophical rule, it must be applicable to all cases. It is the very essence and genius of the Inductive Philosophy to analyze particular cases, deduce general rules from them, and shew how they apply to all other cases. It is the very test of the truth of rival theories to explain particular cases. There is no other way of testing their truth, and, accordingly, when two apparently plausible theories have been brought to the trial, and one of them has failed to account for phenomena, it has invariably been rejected. A true theory, therefore, must account for all the phenomena in a science. It must be true in all classes of cases, and to any extent. A single fact that can be shewn to be absolutely irreconcilable with a theory is fatal to it.

35. In many other sciences it has happened that theories have appeared to account for a considerable number of phenomena, and have for a long time been accepted as true, but in course of time other classes of phenomena were observed which were wholly irreconcilable with the received theory. It, consequently, became necessary to devise new theories capable of comprehending the new classes of facts. Of course it was manifestly necessary that the new theory should absorb all the facts accounted for by the old one, and explain them equally well. When this has happened, when it has been proved that the new theory accounts for all the observed facts, the old theory has been invariably superseded, and the new one adopted.

36. Precisely the same process of reasoning holds good in Political Economy. Just as it is a universally acknowledged principle in experimental science that that law only is the true one, which explains all the cases in the subject, we lay this down as an unquestionable truth in Political Economy:

That if two or more forms of expression will explain or account for any phenomena regarding price, or the change of price, that form of expression only is to be adopted as the true one, which explains all the phenomena in the science, and not the individual case only.

37. Tried by this law, which is indisputably true, the law that cost of production regulates value, breaks down and utterly fails. In the first place there are whole classes of cases to which it is admitted by its author that it is utterly inapplicable, as, for instance, the prices of all objects of art, such as pictures, statues, compositions in music; all questions of personal skill, such as barristers' fees, salaries of actors, the remuneration of authors, besides many others, as, for instance, all cases where the same cost of production produces articles of different qualities. These facts are quite sufficient to seal its condemnation.

38. Moreover, if there be a general form of expression for the causes which universally cause a change of relations of quantities, it must indicate on the face of it all the

possible causes of change, so that by the variation of potency of each particular cause in each separate case, the same general expression may be applicable to all classes of phenomena in the science, and to any extent. *Every true formula, or general rule, must bear on the face of it all the elements which influence its action.* The effects of each element may vary from zero up to any extent, and will modify the result accordingly. Now, take the quality of the result, or the demand for it, as elements which manifestly influence value, and what trace of them appears on the face of the rule that cost of production regulates value?

39. The only true way of constructing a philosophical rule regulating price, or value, is to consider all the causes which affect it. There are a certain set of causes which tend to elevate it, and a certain set which tend to depress it. Price, then, will vary *directly* as the causes which tend to elevate, and *inversely* as the causes that tend to depress it. And that is the method we have adopted in constructing a formula in the beginning of this chapter.

40. And when the general expression we have obtained, is applied to the explanation of phenomena, it is found that it is true in all classes of cases, and to any extent. All the cases which are exceptions and contradictions to the law, that cost of production regulates value, are *examples* of the law of supply and demand, or of the expression we have obtained. It explains not only all classes of cases, but all the range of prices in each class, from 0 up to any extent. It absorbs and accounts for all the cases which are apparently accounted for by the false law. It bears, therefore, all the indelible marks of truth.

41. Tried by the well recognized standard of philosophical reasoning, the Ricardian Law entirely fails. But it is founded on a much deeper error in the nature of commerce. For it is akin to this fundamental fallacy, that people buy because other people produce; whereas the contrary is the fact,

people produce because they hope and expect that others will buy. All production is founded upon speculation. Producers find out or think of what other people want, and then they produce. A constant supply of some things is wanted. Inventors hope that they may excite or create a desire, but it is no reason that people will buy, because others produce, and if none want or will buy what is produced, such an article has no *value*. All production, then, is founded on speculation, varying through all degrees of prudence, certainty, and risk. All producers speculate that there will not only be buyers who shall want their products, but shall want them to such a degree of intensity as to be willing to pay a sum at least sufficient to pay the cost of production, and a profit besides, sufficient to remunerate them for their time and trouble. Now, the powers of consumption generally speaking are limited, but in most cases the powers of production are much more easily extended, and the amount of value, or the price, depends upon the proportion between the production, or the supply, and the number of persons who are willing to give an adequate price, or the consumption, and hence production must always be adjusted to consumption, and not the reverse. Hence, also, we have this fundamental truth that SPECULATION IS THE MOTHER OF PRODUCTION, BUT DEMAND IS THE ORIGIN OF VALUE.

42. Whoever is well acquainted with the subject, must perceive that the preceding considerations contain the entire overthrow of the established doctrines of Political Economy. "Labor," says Ricardo, "is the foundation of all value." We have already shewn in Chapter I. that this is a fundamental error. Value does not spring from the labor of the producer, but from the desire of the consumer. The modern doctrines of Political Economy look entirely to the wrong source for value. Aristotle saw the matter most clearly in its true light. He makes value spring from demand.* While we have had oc-

* Politics. L. III. Nichomac. Ethics. L. v. C. 5.

casion to reject the conception of money as propagated by Aristotle, and adopted by modern economists, we may help to rehabilitate his doctrine of value, which is rejected by modern writers. Labor is, in no case whatever, the cause or foundation of value. No amount of labor, or cost of production, can ever bestow or ensure value. In all cases whatever, it is because articles have great value, that great labor or great expense is expended in producing them.

43. It is, then, universally the RESULT, and the result only, which has value, whether that result be obtained by great or by little labor, although it is undoubtedly true, that valuable results are scarcely ever attained without great labor or expense. Nevertheless, we must rigidly guard ourselves from thinking that it is the labor that confers the value. An able and skilful man may obtain a result of great value with comparatively little labor, and an inferior man may bestow many times the amount of labor, and never attain so valuable a result. No class of persons are so apt to estimate the value of a thing by the labor it has cost them as authors, and consequently it is a very common remark that authors are generally the worst judges of the relative value of their own performances. Archbishop Whately cautions an intended writer of the History of Logic thus, "he should possess the power of rightly estimating each according to its intrinsic importance, and not (as is very commonly done) according to the degree of laborious research it may have cost him."* And this remark is of universal application.

44. In accordance with the erroneous views regarding value which we have alluded to, many writers enter into laborious accounts of the various items which constitute price. Thus, they add wages, and profits of stock, cost of machinery &c., together as the cause of price. Thus, Adam Smith says, "high and low wages and profit are

* Elements of Logic. 9th Edit. p. 2.

the *causes* of high and low price," * and he adds up *natural rent*, *natural wages*, *natural*, &c., and calls the sum of these the *natural price*. Now, the fact is, that prices are not high *because* expensive machinery is employed in producing things, but expensive machinery is employed *because* prices are high. It may be that some persons may think this a subtle distinction, because the two are often so bound up together that it is not easy to separate them, but yet they proceed from two distinct fundamental principles. Adam Smith, whose work is unfortunately so full of inconsistencies, says most truly, in the same chapter as we have just quoted, when speaking of the value of particular wines, "For though such vineyards are in general more carefully cultivated than most others, the high price of the wine seems to be not so much the *effect*, as the *cause* of this cultivation."† Here Adam Smith touched the true fundamental principles of Political Economy, and if he had made this conception the basis of his work, it would have saved a world of trouble and confusion. But, in fact, the tribunes of the commons had enunciated the true doctrine a very long time before; "*Eo impendi laborem ac periculum * * * magna præmia proponantur.*"‡

45. This, then, is the universal law of Political Economy. That people bestow much labor or expense in producing commodities, because they expect that others will give a high price for them. It may be a reason for *asking* a high price, that they have bestowed much labor, but that is no reason why others will give it. In many trades it is perfectly well known that the public will give a certain price and no more for an article, and the problem is to produce the article for the price.

46. We must also be on our guard against admitting a specious form of expression which J. B. Say uses, "Thus, without examining yet, why olive oil is worth 30

* Wealth of Nations. B. I. ch. XI.

† Do. B. I. ch. XI. ‡ Livy. IV. 35.

sous a pound at Marseilles, and 40 sous at Paris, I say that he who sends it from Marseilles to Paris *adds* 10 sous to the value of each pound of oil." * "Products successively increase their value in passing through the hands of their different producers." † It is never the producers that confer value, but the consumers; it is each successive consumer that confers the value. If it was the cost of transport that *added* to its value, it would necessarily follow that to send it back again from Paris to Marseilles would still further add to its value, and to send it backwards and forwards twenty times ought to add twenty times the cost to its value. The truth manifestly is that people incur the cost of transport because they expect that the difference of the value between the two places will repay the cost; but no cost of transport can really add to its value. Thus, a Library or Museum may be brought up to London from the country for sale, but the expenses of the transport do not add to the value of the books, but they are brought up to London because it is expected that their higher value in London will repay the cost of bringing them there.

47. To exemplify, and still further to enforce the truth of our formula, we may take the case of diamonds and other precious stones. Their value depends entirely upon their rarity, and the extreme desire of rich persons to possess them, and has no appreciable relation to the labor of finding them. They have acquired a certain estimation in the eyes of men for certain reasons, and they are scarce, and it flatters the pride of men to be the possessors of rare articles. The finding of diamonds is a great hazard, and they are only found in a few places, and of certain sizes. If a few persons were to be so fortunate as to discover a few hundreds of diamonds of large size, their value would be immensely diminished all over the world; nor would it be possible to assign what proportion

* Traité d'Economie Politique, p. 101. Edit Gillaumain.

† Do. p. 531.

the labor of producing them would bear to their price. On the other hand, were a million of men to devote themselves to search for them, and if they searched in vain, and found none, that circumstance would not have the smallest effect in raising the value of a single diamond. So that the real truth is, that men are willing to devote themselves to search for diamonds, because they are of great value when found. A diamond is not valuable because a great deal of labor has been bestowed on finding it, but a man searches for diamonds because, though he may only find one at rare intervals, the value of it when found is so great, that it will repay him for a long course of unsuccessful labor. Thus, also, pearls are not dear because so many fishermen seek for them, but so many fishermen labor to find them, because they are highly esteemed, and rich people are willing to pay high prices for the pleasure of possessing them. Hence, we may say, that it is true of diamonds and pearls, and all that class of productions, that a great deal of labor is bestowed on producing them, because a high price is given for them, and that it is a mistake to say that a high price is given for them because a great deal of labor is bestowed on producing them. Sidney Smith was in a fever of anxiety to sell some jewels he had, to set up house, lest mankind should awake from their folly and refuse to buy these glittering baubles. No examples can be taken better than these to shew the total want of any necessary relation between *labor* and *value*.

48. An attentive consideration of this last example is of the utmost importance, and is of universal application in Political Economy. We observe that the *quality* of the diamond is not in any way affected by the quantity of labor bestowed on finding it. A diamond of the first water may be found after a search of five minutes; a search of as many days, months, or years, may only be rewarded by finding a very inferior one. But yet the result of the lesser amount of labor may be far more valuable than the result of the greater amount. This

is a universal truth in Political Economy. In all cases it is the *result*, and that only, which is looked to, wholly independent of the labor by which it has been arrived at.

49. Ricardo has brought forward in support of his fundamental principle, that cost of production regulates value, an example that deserves to be examined. He says,* “Gold and Silver, like all other commodities, are valuable only in proportion to the quantity of labor necessary to produce them and bring them to market. Gold is about fifteen times dearer than silver, not because there is a greater demand for it, nor because the supply of *silver is fifteen times greater than that of gold, but solely because fifteen times the quantity of labor is necessary to produce a given quantity of it.*” Such an assertion as that it is fifteen times more expensive to obtain gold than silver carries its own refutation on the very face of it, and is just one of those tests which, being inconsistent with a known truth, proves the fallacy of the whole of Mr. Ricardo’s argument. A gold mine is not more costly or laborious to work than a lead, or tin, or copper mine. But it is a much *scarcer* metal than any of the others, and it is extremely useful for certain purposes. It is not the greater amount of labor bestowed upon producing gold that gives it its greater comparative value to silver, but its greater comparative scarcity to that metal. So far from its being true, as Ricardo says, that the supply of silver is not fifteen times as large as that of gold, the fact is that until the discovery of California and Australia, the supply of silver was forty times as great as that of gold.† The reason why, when it was forty times more abundant, it was only fifteen times less valuable than gold, will be shewn a little further on. Now, this is exactly what Bacon calls a *crucial instance*; and is absolutely decisive of the merits of Ricardo’s system. According to his doctrine, the only reason why gold could be fifteen times more valuable than

* Principles of Political Economy and Taxation, p. 421.

† Macculloch’s Commercial Dictionary. Art. Precious Metals.

silver would be that it was fifteen times more expensive to produce it. But this is known to be a fallacy, and is decisive of the fallacy of the system built upon such doctrines. If gold were as abundant as silver, it would be much more convenient to have silver coin than gold ones, as an equal quantity of silver would be much lighter and more convenient to carry than the same quantity of gold. It is, in fact, the peculiar qualities which render gold so useful as a currency, that give it the greater portion of its value.

50. The different value of houses according to the locality in which they are built, well exemplifies how greatly more surrounding circumstances influence the value of an article than the cost of its production. It would not cost more to build a house, or a range of offices in the heart of the City of London, opposite the Bank of England, or the Exchange, than in the most unfrequented suburb, but of what different values they would be! Now, it is clear that the greatly augmented value of the building in the City would be almost entirely due to the great demand for offices in that locality, and would have no reference to the cost of its production. Nay, so much is value affected by external circumstances, that a house or a shop will be far more valuable on one side of a street than on the other, as it may be more fashionable or sunny, or the reverse. So apparently minute are the circumstances that cause great differences in value. Again, an unexpected change in the fashion, which is merely another name for the demand suddenly ceasing, causes the most violent depression in the value of the most expensive articles. A few years ago a species of carriage called *chariots* were the most fashionable of any—now there are very few remaining, and a good chariot which in former times would have cost several hundred pounds, would not now fetch more than a few pounds, the mere value of the wood and iron, because they have been superseded by more convenient forms of carriages. These examples are sufficient to show how erroneous it is to think that the value or

price of an article can be controlled by its cost of production.

51. The value of pictures, sculpture, and all objects of art is so entirely allowed by the advocates of the law of cost of production regulating value, to be an exception or contradiction to that law, that we need not further allude to them, than to remark that they are examples of the law of supply and demand, and are universally allowed to be so.

52. Many railway companies, in regulating their fares, have acted upon an error analogous to the doctrine that the cost of production regulates price. It used to be not an uncommon argument for keeping up fares very high, that the cost of making the railway was very high, and *therefore* the fares must be high. The two things have no relation whatever. The object should be so to regulate the fares as to produce the greatest amount of revenue possible. The companies should have calculated before making the railway, the amount of revenue they could probably obtain, which would determine the value of the railway when made, and then the cost of making the railway, and if the revenue would pay the interest of the money expended in making the railway, then they should make it, otherwise not.

53. It is quite easy to shew that the value of an article may diminish, as the cost of its production increases. Let us take the example of a ship, as that will illustrate this principle as well as any other. The value of a ship at any given time (omitting the question of how long she may last) is measured by the amount of freight she can earn. If the demand for ships be great and the number of them few, the value of shipping will of course be high; but if the number of ships be increased, while the demand for them remains the same, the value of each will be diminished. Now, if the value of ships be high, it will naturally cause a greater number to be built, which will stimulate industry in that trade, and certainly cause an advance in shipwrights' wages. Thus, the cost of pro-

duction of each ship will be increased, while each new ship that is built will diminish the value of the whole; and the more that are built will still further diminish their value, till at last the value of each will diminish so much, that it will scarcely exceed the cost of production, and then they will cease to be built. If the demand varies as well as the supply, it is quite easy to discover what its effects must be according as its rate of increase is greater, equal to, or less than the supply.

54. It is far more generally true that it is the value of the article when produced that governs the cost of production, than the contrary rule. It is true that it is often said that the prices of goods are raised because wages have risen,—as was the case with the iron trade in 1854—but, then, what was the cause of the rise of wages? Simply a greater demand on the part of the public for articles of iron, for ships, for rail-roads, steam engines, &c. It was this original demand on the part of the public for iron that raised the price of labor, and the rise of wages reacted upon the price of iron. The producers of iron articles were able to raise their price to the public because there was a great demand for them. The demand by the public increased faster than it could be supplied. If the increased supply required could have been furnished as quickly as it was wanted, there would have been a rise in wages, but not in the price of the article itself. Hence, the true cause of the rise in the price of the article was not the rise in wages, but the demand for the manufactured article increasing quicker than it could be supplied. A few months after that, a great revolution took place, the price of iron fell 30 per cent., and wages were reduced; but was it the reduction of wages, *i.e.*, the cost of production, that caused the fall in the price? Certainly not, but it was the fall in the price caused by a diminution of the demand compared to the supply, that compelled a reduction in the cost of production, or wages.

55. The fundamental fallacy of the doctrine, that

the cost of production regulates value, is that it wholly omits to take into consideration the effect that an excess of quantity has in depressing the market. If producers of articles had always a full knowledge of the supply that would be required, and refrained from throwing more on the market than could be taken off at a remunerative price, that doctrine might appear more specious. But all commerce is full of overtrading, and if commodities are thrown upon the market, there is no limit to the depression of price they may undergo, whatever may be their cost of production. When this is the case, the article ceases to be produced until the excessive supply is worked off, and the price has risen on account of the increased proportion of demand over supply. As soon as the enhanced price caused by the limitation of the supply, and by that only, makes it profitable to produce, production will be resumed. If the price continues to rise, production will be still further stimulated, and capital will be attracted into that branch of business, until the increased proportion of supply compared to the demand again causes the price to fall. But in all these cases it is the rise or fall of the price that attracts or repels capital, and not the employment of capital that regulates the price. The idea that cost of production regulates value proceeds upon the supposition that the individual can control the market, whereas in all ordinary cases it is the market that controls the individual. In those exceptional cases where a single individual has such power over the production of any article as to be able sensibly to influence the market, he can of course raise the profits of that article far above the usual commercial profits, simply from his power of keeping competitors out of his line of business.

56. These considerations are sufficient to shew the fallacy of the doctrine, that it is the cost of production which regulates price or value. On the contrary, it is generally the value an article is expected to have, when produced, that causes it to be produced. The difference between the cost of its production and its value is called

the *profit*, and the course of a prudent man would be, first to calculate the cost of production of the article, then to consider what would be its probable value when produced, and if the difference between the two, or the profit, is sufficient to make it worth his while to produce it, he will do so, if not, he should try to discover some more profitable operation. If the value of the article when produced is only equal to, or less than the cost of production, he must sell at a loss, and repeated operations of this nature will end by ruining him. The history of all commerce is but too full of examples of the value of articles falling below their cost of production, and of mercantile enterprises which never pay their expenses. There is but one way by which a producer can govern price by the cost of production, and that is when he can obtain a command over the supply, and limit it artificially, and not produce more than the public can be made to buy at a particular price. The Dutch acted upon this principle when they conquered the Spice Islands in the Eastern Archipelago. With contemptible selfishness, they cut down three-fourths of the spice-bearing trees, and so artificially enhanced the value of the remainder. It is also said that there is but one mine in England which produces plumbago, or black lead for pencils, and this being in the hands of one proprietor, he carefully limits its annual produce to force up its price in the market.

57. The doctrine, that no change in the cost of production will produce a change in value, unless it is accompanied with a change in the relation of supply and demand, furnishes a very simple solution of what J. B. Say declares to be one of the most thorny questions in Political Economy. He states the question thus :—"Wealth, being composed of the value of articles possessed, how can it be that a nation shall be just the more rich, as things are there at a lower price?"* The problem, as far as we understand it, is this, "If wealth depends upon the value of

* Cours D'Economie Politique. Vol. 1. p. 371. Edit. Gillaumin.

articles, how is it possible that a nation can be richer when cotton goods are 6d. a yard, than when they were at 3s. 6d. a yard? The answer is very simple. Let us suppose that, at any given time, cotton goods were 3s. 6d. a yard, and there was only a certain number of people who could afford to buy them at that price, but there were a great many others who would buy them if the prices were reduced within their means. Now, the question is, to discover what reduction of price will enable any given increased production of cotton goods to be bought. What reduction of price, for instance, will cause the consumption to be doubled? Now, if by ingenious devices the manufacturers can diminish the cost of production of the cotton goods to one fourth, but no increased quantity is produced, we have already shewn that no reduction in price will ensue. Hence, we may say, that the value of the cotton goods, (*i.e.*, what people will give for them) is 3s. 6d., without reference to their cost of production. Now, if the change in price bore the direct proportion to the change in the relation between supply and demand, it would require the price to be reduced one-half before the consumption could be doubled. That is, though a greater number of individuals might receive the convenience of having cotton goods, still the total value of the whole quantity produced would still be the same as it was before. But in practice this is not found to be the case. Instead of requiring a reduction of one-half in the price to ensure a consumption of double the quantity, it is probable that a reduction of a fifth, or a fourth in the price would do so. If a reduction of 1s. were effected in the price, it would probably quadruple the consumption. Then the value of the total quantity consumed would be 10s. instead of 3s. 6d. Consequently the total wealth of the nation would be increased by that amount. And as the price was still further reduced, the consumption would proceed in a still more rapid ratio, in proportion to the greatly increased number of persons who would find the article within their means of purchase. A reduction of the price from 3s. 6d. to 6d., instead of increasing the

quantity consumed sevenfold, would probably increase it a thousand-fold. That is, as the diminution in price proceeded in an arithmetical proportion, the quantity consumed would increase in a geometrical proportion of a very high order. And the value of the totality of the article would proceed in a similar ratio. Thus, though the value of each individual yard was seven times greater in the former case, yet the value of the total quantity produced would probably be at least a hundred-fold in the latter, and the wealth of the nation is to be judged by the value of the totalities, and not by that of each yard. This is universally true. The value of the totality of the cotton manufactures of Great Britain is probably a hundred-fold now, to what it was when the value of each piece was ten-fold what it is now. So of books. The value of the totality of book manufactures is now probably a hundred-fold what it was when each separate book, being in M.S., cost a hundred-fold as much. The only apparent paradox in the case, lies in the ambiguous form of expression in which Say has stated the question, because in the first part of the sentence, "the value of the articles possessed," it manifestly means the totality of the articles possessed, in the latter part it refers to the price of each individual article.

58. Persons who engage in trade must live by their trade; they must, therefore, necessarily charge their customers such prices as will enable them in the long run to support themselves out of the profits. Hence, when transactions are very trifling in number and magnitude, they must charge very high prices in order to enable them to live. But when the transactions increase in magnitude and number, they are enabled to reduce the profits upon each, and lower their price. It is this circumstance that compels small shopkeepers in rural districts to charge such high prices for their goods, to the great indignation of many well-meaning but unreflecting persons. It is not uncommon to hear such persons exclaim against what they call the extortionate charges of country shopkeepers, quite forgetting that if the traders cannot make a living

out of their business, they must give it up altogether, and the people be totally deprived of the convenience.

59. It has sometimes happened that gentlemen, having plenty of other means to back them, have established rival shops for the express purpose of beating down the prices of the country shopkeepers. The consequence has been that the traders who had nothing but their business to support them have been ruined, the gentleman in process of time either got tired of his whim, or for other reasons abandoned it, and the germ of a nascent trade in a district destroyed, a pregnant example of the Spanish proverb,—“Hell is paved with good intentions.”

60. There can be nothing more mischievous or injurious to a trade than for persons to interfere with it who are not regularly engaged in it. Mr. Laing mentions a very remarkable instance of this at Drontheim.* “I was surprised on inquiring at the only bookseller’s shop, for a new testament in the Norwegian tongue, to find that he kept none; I thought at first he had misunderstood me, but really found that he did not keep any of late years. As he understood German, I asked him how in a population of 12,000 people, the only bookseller kept no stock of testaments and bibles; he said that country booksellers did not find it answer, as the Bible Society in London had once sent out a stock which were sold much lower than the trade could afford, and it was only after the Society’s bibles were sold that they could get clear of what they had on hand; hence, they could not venture to keep any now. It is plain if any benevolent society were to supply a parish with boots and shoes below prime cost, until all the shoemakers in the parish had turned to other employments, the parish would soon be barefooted, and that they would do more harm than good unless they had funds to continue the supply for ever. This bookseller, a very respectable man, laid no stress upon the circum-

* Residence in Norway, p. 79. Traveller’s Library.

stance, but simply explained it as he might have answered any other inquiry about books; and a bookbinder, whom I afterwards saw, gave me the same reason. Men of the first capacity are connected with our societies for the distribution of the scriptures, and it may well deserve their consideration whether such distributions may not, in the long run, do more harm than good. If the ordinary mode of supplying human wants, by affording a fair remuneration to those who bring an article to where it is wanted, be invaded, they may be interfering with, and stopping up the natural channel, by which society must in the long run be supplied with religious books."

61. Thus, is the science of Political Economy vindicated by experience. There is nothing more certain to destroy trade and commerce, and to augment the very mischief complained of, and sought to be remedied, than an irregular and capricious interference with it. In 1775, during a severe scarcity in France, the municipality of Lyons and several others, bought up corn in the country, and sold it at a loss in the city. At the same time, to defray the expense of this operation, they imposed an addition to the *octroi*, or the duty which provisions pay on entering the town. These measures only augmented the distress, the market of the persons who were regularly engaged in the trade was destroyed, they saw themselves undersold, and when they introduced provisions they were taxed for it.* During a scarcity in the year 362, the Emperor Julian sold at Antioch, at a very low price, 422,000 modii of corn which he brought from Chalcis and Egypt; this distribution destroyed the regular trade and increased the distress.† The Roman Emperors were in the habit of making gratuitous distributions of corn, the consequence was that this greatly injured the regular trade, and Rome was in a state of chronic distress. So in France in 1789 a scarcity was apprehended. Necker

* J. B. Say. *Traité d'Economie Politique*, p. 213. Edit. Gillaumin.

† Gibbon. Ch. 24. Vol. iii., p. 183. Murray's Edit., 1854.

pompously announced that immediately on his becoming minister, he hastened to obtain information as to the produce of the harvest and the wants of foreign countries. J. B. Say aptly remarks, what satisfactory information could a minister obtain? The mayor of a village could not tell what quantity of corn his own commune had produced; how, then, could a minister ascertain what a vast kingdom had produced, and how much had been sold. Arthur Young, who travelled in France in that year, says that he was every where told that the harvest was an ordinary one, and that as soon as Necker announced in the National Assembly that the government had bought up 1,400,000 quintals of corn abroad, of which 800,000 had already arrived, which it would appear should have lowered the price of wheat, the price immediately rose in all the markets of France.* In the year 1847 there was, as is well known, a severe scarcity in these islands, owing to the failure of the potatoe crops. In the county of Ross in Scotland, the distress was felt, though not nearly to so great an extent as in Ireland, or in many other counties, owing to the fortunate substitution of the large farm system for the cottier system.† There were abundance of meal dealers in the county; nevertheless at a special county meeting, the gentlemen of the county determined to take measures to obviate the apprehended scarcity, and provide meal. Their intentions no doubt were very benevolent, but this injudicious interference with the ordinary course of trade only resulted in bringing a considerable loss on themselves, and making meal dearer than it was before. Thus, the true principles of science manifest themselves in all countries and times.

62. It is because that no single trade is sufficient to occupy a man's time or gain him a livelihood, that dealers

* J. B. Say. *Cours d'Economie Politique*. Vol. II., p. 184. Edit. Gillaumain.

† See my letter to the Board of Supervision in Scotland, "On the Effects of the Establishment of a Poorhouse in Easter Ross," printed in the Appendix to their Seventh Annual Report to Parliament, 1851.

in country districts, and in the commencement of trade, are obliged to unite so many different kinds of business. At a small watering place in England we saw the prospectus of a tradesman, who united thirty-six kinds of trade. As population and wealth increase there are more demands in each of these different kinds of business, and the trader finds he can gain a living by confining himself to a fewer number. At last, every one confines himself to one business alone, being able to make a livelihood out of it. Thus, also, in the rise of the arts, Michael Angelo was sculptor, painter, architect, and engineer. Gradually these employments disintegrate. Not only, in time, each man confines himself to a single trade, but even to one small department of a trade. Each department of trade separates itself into a distinct employment. This is also universally the case in the sciences, as soon as they attain a certain magnitude. Not only, in modern times, do men devote themselves to a single science, but in many cases, a single branch of that science is sufficient to employ a lifetime. This is that principle of the separation of employments, or the "division of labor," which Adam Smith has obtained so much fame for explaining, but which was perfectly well known and observed long before his time.* At Venice, so early as the 12th century, it was forbidden to every workman to employ himself in more than one sort of trade, in order to make him bring that to greater perfection.† And the same law was enacted by Philip le Bel in France.

63. Hence, we see that, when transactions are few and paltry, prices, and the profits upon each, must be high, and that a multiplication of transactions, and an increase of their amount, has a tendency to lower prices. Nowhere are rents so high as in the city of London; and nowhere are prices for ordinary goods so moderate. Goods in the city are in many cases twenty-five per cent. cheaper than

* By Xenophon for example.

† Blanqui *Histoire de l'Economie Politique*, Ch. xx.

in the suburbs, and this is not entirely the result of competition, which is equally active in the one as in the other, but is the result of the great number and magnitude of their transactions. The profits upon each transaction are much less than a country shop-keeper receives; but it is found that a small profit upon a large and rapid circulation of commodities leads much faster to opulence, than a large profit upon a slow and small circulation. Instead of the grasping rapacity which formerly used to make as great a profit as possible upon each transaction, modern experience demonstrates that the true axiom of trade is *small profits and quick returns*.

64. It is unquestionably true, that a very rapid sale, accompanied by an unlimited supply, has the effect of lowering prices, even where the cost of production is increased. As a familiar instance, we may take the fares of cabs in London and the provinces. Cabs are sixpence a mile in London, but much higher in all provincial towns. Now, the cost of maintaining cabs, feeding horses, rent of stables, &c., is much higher in London than in the provinces. And, therefore, according to the notion that cost of production regulates value, the fares ought to be much higher. But the fact is, the demand for cabs is much greater in London than in the country. A London cabby gets many more fares than his provincial brother. Thus the returns are made so much more quickly, that a much greater amount of profit is made in the same time, and fares adjust themselves to that.

65. Bacon saw clearly, what has been far too much overlooked by writers on Political Economy, that the frequency of returns is of far more consequence than the magnitude of each case of profit. "The proverb is true that light gains make heavy purses, for light gains come thick, whereas great come but now and then."* In fact, a great deal of misconception has arisen from the want of always considering that profits must always be reduced

* Essays; Of Ceremonies and Respects.

to the standard of the year. Profits must always be estimated at so much per cent. per annum. In common parlance interest is always reduced to this standard, and no confusion arises; but this is scarcely ever done with regard to profit, and hence much misconception arises. Adam Smith uses the expressions "rate of interest" and "rate of profit," without seeing that both rates must be reduced to the same standard. The whole of Ricardo's chapter on profits is based upon this most palpable fallacy. His doctrine is that profits depend purely on wages. They fall as wages rise, and rise as wages fall. Mr. J. S. Mill adopts this conclusion, with a verbal alteration, which no doubt more truly expresses Ricardo's meaning than his own phrase. Mr. Mill says* that they depend on the *cost of labor*, i.e., the efficiency of the result compared to the cost of it.

66. Ricardo's error and that of his followers is in confounding the *actual profit* with the *rate of profit*—the *absolute quantity* with its *rate*. Now, it happens that the rate of profit on each transaction may be the greatest, where the actual profit is the least. Thus, if a man were to make a profit of 50 per cent. on one transaction, that would be a high profit. But if he only made one transaction in the year, he would not increase fast in opulence. His rate of profit would be 50 per cent. But suppose that he only makes a profit of 5 per cent. on a transaction, but makes that profit in one day, then the rate of that profit is upwards of 1,700 per cent. per annum, and if he could make a transaction at that profit each day, his actual profits would be upwards of 1,700 per cent. Hence, the rate of profit would be very high, but the actual profit would be very low. And if the trader re-invested the profits as they occurred as capital, his rate of profit on his original capital would increase at compound interest, and be enormously greater. Now, if transactions are effected very slowly, we have before shewn that the

* Principles of Political Economy. Vol. I., p. 509.

actual profits on each must be very high, and circulation will not be brisk, consequently wages will not be high; but if the circulation increases and transactions are effected with much greater rapidity, it is an infallible certainty that wages will rise. The actual profit upon each transaction will diminish, but the rate of profit will enormously increase. No where are wages so high as in the City of London, no where are the actual profits on each transaction so small, and no where is the rate of profit so great, or the increase of opulence so fast.

67. This doctrine of the rate of profit has been most grievously misunderstood. Mr. Mill says,* "The cost of labor, then, in the language of mathematics, is a function of three variables, the efficiency of labor; the wages of labor, meaning thereby the real reward of the laborer; and the greater or less cost at which the articles composing that real reward can be produced or purchased. It is plain that the cost of labor to the capitalist must be influenced by each of these three circumstances, and cannot be affected by any others. These, therefore, are all the circumstances which determine the *rate of profit*, and it cannot be in any way affected except through one or other of them." To which we reply, that a very much more effectual way of affecting the rate of profit is to increase the rapidity of sales. A profit of 5 per cent. made in one day is three times a greater rate of profit than 50 per cent. made in one month. When a man has bought goods and sold them again, he is said to *turn over his capital*. Now, every trader knows that what conduces most to his opulence is not making a large profit upon a few transactions, but upon turning over his capital as often as possible, and that he will probably get rich much faster where his profits are the smallest. These considerations will be illustrated more fully hereafter, when we come to speak of interest.

68. The formula we obtained explains a very well

* The Principles of Political Economy. Vol. I., p. 510.

known phenomenon in the change of prices, that a small variation in the quantity of corn causes a greater variation in the price of bread than a similar variation in the quantity of any other produce causes in its price. Bread is an article of prime necessity to mankind, whatever else fails they must have that, and they cannot do without it for any length of time; consequently, as the supply diminishes, and people begin to feel the want of food, not only is it a service of greater intensity to supply them, but the power of the seller greatly increases over the purchaser, as the former can hold out much longer than the latter. The necessity of the purchaser is much greater than the necessity of the seller, and of course the sellers will have acuteness enough to take advantage of their power, and so the price of bread is rapidly raised. On the other hand, if there be a superabundance of corn, the power of the purchaser to eat is not increased in proportion. He must have a certain quantity to eat, however scarce food is; and he cannot eat more than a certain quantity however abundant it be, consequently, as the quantity of corn increases, and only a certain quantity can be consumed, it is every producer's wish to have his own disposed of, and his eagerness to sell increases the power of the purchaser over him in a very rapid degree, which causes a great fall in the price.

69. A diminished quantity in the supply of wool does not cause, by any means, so great a variation in the price of cloth as in the case of corn, because it is no such great necessity for a man to have new clothes as food. If times are hard, and he must economise, he may deny himself new clothes for a long time, and consequently the seller of clothes has by no means such a powerful hold over him as the seller of food. On the other hand, an increased supply in the quantity of wool does not cause such a diminution in the price of cloth as an increased supply of corn in the price of bread, because when people are well to do and thriving, they are apt to indulge themselves in new clothes before most other things, and they

can increase their consumption of clothes to a much greater degree than they can their consumption of food, and this keeps up the demand for them, and prevents their price falling.

70. Corn is an excellent example to show the fallacy of the maxim that price depends upon the cost of production. When the farmer has produced corn he does not regulate the price of it by the sum it costs him to produce it, but he endeavours to obtain as high a price as he can squeeze out of the necessities of the public. The farmer sells his corn to the miller, who bestows his industry upon it, and sells it as flour to the baker. The baker bestows his industry upon the flour, and sells it as bread to the public. Now, it is evident that the cost of the article at each stage of these operations is the sum of the cost of all the preceding ones, together with the price which the holder of the corn may set upon his own industry, and the ultimate price to the consumer, to enable all these operations to be conducted permanently, must be *at least* the sum of the cost of all the previous operations. But no one will say that is its instantaneous value. On the contrary, it is notorious that each holder at every stage does all he can to aggravate the difference between the cost of production and the instantaneous value. The cost of production is merely an inferior limit, below which the instantaneous value must not fall, if the business is to be self-supporting. The farmer seeks every opportunity to raise the price of corn to the miller—the miller strives to buy as cheap as he can from the farmer, and sell as dear as he can to the baker, and the baker tries to buy his flour as cheap as he can from the miller, and to sell his bread as dear as he can to the public. And the power of the holder at each stage of the operation is limited and controlled by the necessity he has to sell, either on account of the depreciation of the article itself by time or by his other necessities; but limited and controlled by these circumstances, the operations of each are wholly independent of each other.

71. Both these cases of corn and wool, shew how the instantaneous value depends upon the ratio of supply and demand, but they do so in different degrees. Corn is, probably, the most sensitive of any article, from the magnitude of the interests involved in it, and the constant necessity that exists for transactions taking place in it. There can be no better subject to exhibit the extreme sensitiveness of value to the influences of the instant, without reference to anything else. A few fine or wet days, or a passing rumour in Mark Lane, may produce a very material alteration in prices. It would be easy to shew that the very same considerations apply to every commodity, though not in so perfect a degree. Though the prices, therefore, of all commodities are governed by the same principle, they are affected in very different proportions; and the degree of variation produced in each one by an alteration in the ratio of supply and demand, depends upon its own peculiar circumstances, which it would be manifestly impossible to discuss here.

72. The description of sales we have hitherto been considering are all voluntary, and we have seen how the rule we obtained acted in each of them. But there is another very large class of sales, which frequently occur; and our rule would be wholly wanting in that generality which we claim for it, unless it also accounted for them. The class we allude to includes forced sales of all descriptions, where, under the pressure of particular circumstances, persons are obliged to part with their property. Such, for instance, are all sales of bankrupt stock. It is well known that a forced sale is almost universally a loss to the seller, and that he very rarely gets what, under other circumstances, would be the ordinary value of the article he parts with. And this is simply because on account of his necessity to sell, his power over the purchaser is diminished, he must tempt the purchaser to buy by giving him an advantage in doing so. If the purchaser does not much require the article, the service is one of small intensity, and the seller must part with his

property at a sacrifice. Thus, the power of the purchaser increases over him very rapidly, and the price diminishes in proportion. On the other hand, many persons sometimes attend the sale, and bid against each other, and so raise the price, because, as the number of competitors to purchase increases, the power of the seller over each of them begins to revive, and it may happen, that if the competition is very keen, the article may be sold at its full value.

73. We have in the preceding chapter carefully distinguished between the expressions *depreciation* and *diminution in value*; the former being internal, and the latter external. Under the operation of the principle of demand and supply, an article which may be greatly deteriorated in quality, and therefore *depreciated*, may from the great demand for it, and its scarcity, be greatly increased in value. A familiar, but extreme instance of this, is what sometimes occurs in besieged towns, when the vilest food often sells for fabulous prices. So also the price of lodgings, during the assizes, races, or any public festival. A second-hand book may be considered as depreciated in a commercial point of view. It matters not that it be perfectly clean and good in every respect, if it has been the property of a purchaser for a day, the charm of novelty is gone, and it loses greatly in selling value. But if it be a work of celebrity and scarce, a second-hand copy will sometimes sell for more than the original published price. An instance of this was the first edition of Professor Peacock's *Treatise on Algebra*. It was soon out of print, but so great was its fame, that well worn second-hand copies cost more than its price when new. In 1707 a second-hand copy of Newton's *Principia* sold for four times its original price. We shall find that the difference between depreciation and diminution in value of the currency is of great importance in a future part of the work, and we cannot give a better illustration of it than an answer by one of the witnesses before the Bullion Committee:* "Are not the Bankers in the habit

* W. Merle, Esq., Bullion Report Appendix, page 54.

of giving a premium for silver? * * * * I have given £101 for a quantity of coin worth about £60 if it was melted down, though passing for £100, but I have given that premium, bad as it is, particularly at harvest time; it is always very scarce then."

74. We have seen that Profit is in all cases the object or the inducement to production, and when profit ceases, production ceases. Bentham either originated or did much to propagate a doctrine that production is limited by capital. This doctrine is founded upon that rudimentary idea of capital we have described in the preceding chapter. But when we look at the extended meaning of capital, the doctrine is scarcely intelligible. It may possibly be true in some remote and indefinite extension of production, but for all practical purposes this proposition is useless. For all practical purposes production is limited by profit. There is no enterprise in this country for which capital cannot be found, and the way to curb production is to destroy profits. The fact is that capital, which includes credit and industry, is so redundant in this country, that there is a constant tendency to over-production, which requires to be curbed in time. The difficulty in this country is not to find capital, but to discover profits. Whenever a profit is to be made, there will always be found abundance of capital to make it.

75. As a general proposition it is no doubt greatly to the advantage of the general public that things should be abundant and cheap. But there is a very manifest limit to this. It is not good for the permanent interests of the public, that the prices of commodities should fall below the cost of their production, because if they do so the producers will be ruined, and the public will either want the article altogether, or the price may afterwards become high, owing to the scarcity of the thing. When the market price of a commodity falls below its production, it is called OVER-PRODUCTION, and it shews that further production should be curbed. It

is manifestly the best for all parties that the prices should just be so low as to leave the producers a fair average profit. It would not be for the permanent interest of the people, that the price of corn should be so low that the producers of corn would be ruined. And it is highly desirable for the general benefit of all parties, that if such a misfortune should threaten, as timely notice of it as possible should be given, to enable people to accelerate consumption and curb production, and arrest the calamity. On the other hand if there is danger of an unusual scarcity, it is also equally for the benefit of all parties, that timely notice of it should be given, so that not only consumption may be retarded, but production stimulated—in each case, in order to restore the usual equilibrium between production and consumption, as quickly as circumstances will permit.

76. We have observed, that the price of an article at any given time, depends upon the ratio of supply and demand. A fluctuation in price, then, arises from a change in these proportions. When the supply of an article is diminishing as compared to the demand, the price rises, the article rises in value compared to money, and money falls in value, compared to the article. When the supply is increasing faster than the demand, the phenomena are reversed, then the price falls, the value of the article falls compared with money, and money rises in value compared to the article. These changes in price especially in articles of prime necessity, are very inconvenient. As all commercial transactions are estimated in money, all profits and losses are reckoned simply by the difference between the money expended on producing a result, and the money received for it, it would no doubt be much more convenient for all parties if prices did not change. These fluctuations in price being felt to be inconvenient, very inaccurate conceptions on the subject became prevalent, and it came to be considered that these variations were the evil, and many attempts have been made by various laws, in nearly

every country, to fix prices at a uniform rate. But the fluctuation of prices is not the evil, it is only the *sign* of the evil. The real evil is the change in the proportion between supply and demand. When the supply is greatly diminished, and the price rises very high, it is not the high price which is the real evil, but the scarcity of the article. When the supply is excessive, and the price falls very low, it is not the low price which is the evil, but the over-production of the article. A fluctuation in price so far from being the evil, is, in fact, the great corrector provided by nature to remedy the evil. When the evil is scarcity, a rise in the price not only warns people to be economical in the consumption of the article, but, by the hope of profit, attracts it from other places, where it is more abundant, and so provides the only natural remedy that is possible for a scarcity, namely a more abundant supply. A rise in prices is a signal of distress to attract relief; it is a beacon to warn consumers of the danger of an exhaustion of the article, and it is the only beacon they can have. It was formerly the idea, that wicked farmers and corn-factors, were the sole causes of high prices, and whenever they occurred, it used to be the fashion to wreak the popular vengeance upon these men, who were, in fact, the greatest benefactors to the public. And such ideas are not wholly eradicated from the vulgar yet. The Patriarch of modern Political Economy, says with weighty wisdom,* "Ce que l'on appelle la cherté est l'unique remède à la cherté: cherté foisonne;" an immortal truth, which it would be well if the rulers of his country in the 19th century would lay to heart. On the other hand, when the supply is too abundant, so that prices fall below a remunerative level, a fall in the price gives warning to producers to diminish their productions, in order that the value of their produce, may not fall still lower, and it *repels* those articles from coming where they are

*Euvres de Quesnay, p. 66. Edit Gillaumin.

already too abundant. Paradoxical, therefore, as it may appear, a rise in prices is a warning for the ultimate benefit of consumers, to prevent them ruining themselves by too rapid a consumption; a fall in prices is a warning for the ultimate benefit of producers, to prevent them ruining themselves by over-production. Though, like many other medicines, these changes are chiefly distasteful to the very persons for whose ultimate benefit they are. The fluctuation in price is exactly identical in principle with the governor of the steam engine. When steam is rushing in in too great quantity, the governor is adapted by machinery so as to cut off the supply; when the supply of steam is too small, the governor opens the valve and admits more. Consequently a change in the velocity of the governor is the corrector of the evil, which is a change in the uniform quantity of the supply of steam. Now, a fluctuation in price acts exactly in a similar way to the governor of the steam engine. It is the great natural corrector provided to preserve the uniformity in the proportion of the supply, compared to the demand. It is the great regulating power of commerce to guard against the evils of scarcity and excess. And those who interfere with the course of nature by attempting to fix prices, do exactly as foolish a thing, as if they were to attempt to force the governor to revolve with uniform velocity.

77. We thus see the truth more clearly of what was said in paragraph 74, that the principal way to encourage production is by the increase of profits; *the proper and natural way to curb production is by the annihilation of profits*, a principle of the first importance in practical Political Economy, as will be shewn more fully hereafter.

78. In the observations we have hitherto made, we have tacitly assumed that the currency was an invariable standard of value, and that the changes in price were caused solely by the action of a change in the relative demand and supply of the commodities themselves; nor in the examples we have given would there be any error in doing so,

because they were all supposed to be transacted in a very short time. But if we compare prices at long intervals or periods of time, there are other causes of a more complicated nature, which come into play, and must be taken into consideration, which arise out of a variation in the value of the currency itself. It would be premature here to enter into any discussion of the variation in prices alleged to be produced by the issues of Banks, as that would anticipate the consideration of the credit system, which we have not yet come to. We shall not then, at present, speak of any changes in the value of the currency except those that would occur under a purely metallic system.

79. The first requisite of any substance used as a currency is steadiness in value, and just as that steadiness approximates to invariability, the more desirable it becomes. The currency being not only the evidence of services due to the possessor of it, but also the measure of their amount, it would manifestly be of great advantage that the same amount of gold should always be able to purchase the same amount of service, that is, that the value of the currency should be uniform. To have a currency constantly changing its value would be as inconvenient as to have the length of the yard measure changing from day to day, or to measure time by a clock which was constantly changing its rate of going. These two cases are entirely within our own control; we can absolutely fix the length of the yard, and our mechanism is so perfect that we can almost attain perfect accuracy in our measure of time, and even if that should fail, we can always detect the minutest imperfection by the unerring clockwork of heaven. But, unfortunately, the case is far different in the measure of value, which is constantly liable to undergo a change.

80. As the exchangeable value of the currency and the debts it represents, or the services it can command, follows exactly the same rules as the relative values of any other commodities, a change in the value of the currency may be attended with very serious consequences. In the

operations of buying and selling it may be of comparatively small importance, because these take so short a time to be completed that no perceptible change can occur. But it often happens that debts are contracted which are not intended to be discharged for long intervals of time, such as mortgages on landed property, and the changes in the value of the currency between the times when the contract was made, and the time when it has to be fulfilled, may have very ruinous consequences to individuals. Thus, the owners of estates frequently borrow large sums upon agreeing to pay interest for their use. Now, if any serious diminution in the quantity of the currency takes place, it is evident that the commodities raised from the land which enable the landlord to purchase the gold which he has promised to pay, may not be able to purchase so much of it as they might have done when the contract was made, and then he may be ruined, although the commodities themselves are as useful as ever they were, and their exchangeable relation with other things, except money, may not be altered. In other words, his rents will fall while his debts remain the same. But if a great increase takes place in the quantity of the currency, his commodities will purchase a greater amount of it than they could before, and as he only promised to pay a certain quantity of gold, he has more to spare after he has fulfilled his contract. That is, his debts remain the same, and his rents will rise. The greater part of the community are included in the classes of debtor and creditor, and their interests are always opposed to each other; it is always the interest of the former that the quantity of the currency should increase, and of the latter that it should diminish, while true justice can only be done between them when the measure remains invariable.

81. But these inconveniences, great as they are, are by no means the most important that may occur in modern times from a serious alteration in the value of money. Private contracts of debt are generally not for a longer period than a few years. But, since the last great altera-

tion in the value of money, by the discovery of the mines in America, a new species of contract has sprung up of a far more important nature. And these are the public debts of the various states of Europe. These debts are contracted in perpetuity. It is the very object of these debts that the State should never be compellable to pay off the principal. If an individual wishes to realize his debt, all he can do is to discover some one else who will buy it from him, and the price is a matter of private arrangement between these parties. All that the State contracts to do, is to pay a certain definite amount of bullion in perpetuity to the holder of the stock. Now, if the exchangeable value of money undergoes a very serious change, either one way or the other, it may have very serious effects, either upon the state itself, or upon the property of individuals. If the value of money rises to a great extent in consequence of a very great scarcity of the substance of which it is composed, the public debt will become a much heavier burden on the industry of the nation than it was before. Although the nominal amount may be the same, yet the spirit of the contract will be entirely altered. Some writers assert that this happened at Rome in the second Punic war. The public debts of Rome were contracted in copper. When they were contracted, copper was an extremely abundant metal in Central Italy. It is asserted, however, that it afterwards became extremely scarce, so that the spirit of the contract between the State and its creditors was entirely altered, to the disadvantage of the former. Under these circumstances the *as*, the Roman unit of value, was reduced from a lb. to an ounce, and some writers maintain this reduction was only proportional to the increased value of copper, and was, though in appearance a bankruptcy, only an equitable arrangement between the two. We cannot inquire here, what foundation there may be for this opinion, but it is perfectly possible in the nature of things. On the other hand, the material of the currency may become unexpectedly and remarkably abundant, so

that it may undergo a serious diminution in exchangeable value, and then of course the State will gain, and the creditors will lose. There is no doubt whatever that these changes in the value of money do occur in course of time, and under a system that contracts to pay a definite amount of bullion in perpetuity, it must happen that in the lapse of time the equity of the original contract is departed from, to the prejudice of one party or the other.

82. When we said that prices depended in every instance on the relation between the supply and demand, we may appear to have alluded only to the article itself, and to have considered the money as a fixed quantity. Nor is there any real error in our argument from doing so, because the variations in the real value of money are extremely slow, and the variations in the value of commodities are extremely rapid. So that for short periods no error whatever arises in considering the value of money as fixed. Just as in astronomy the changes of the position of the heavenly bodies, which are at a very great distance from us, are barely perceptible after long continued observations, and they may be used to serve as standard to note the changes in position of those which are comparatively speaking close to us—such as the moon and planets. And the former are termed “fixed,” though in reality it is known that they are all in rapid motion. So for short periods, the value of money may be considered as fixed, without material risk of error; and changes in the value of money may be compared to the secular variations of the heavenly bodies. Now, it is a question of very considerable interest to inquire what are the circumstances under which an alteration in the value of money can take place, and whether there is any danger of the prodigious supplies from Australia and California producing the same changes as the discovery of America did.

83. Lord Lauderdale has stated that in regard to the exchangeable relations of two quantities in reference to each, assuming one of them to be fixed for the time being, that there are four causes which will influence the ex-

changeable relations of the other towards it. It would be subject to an increase of its value from —

- (1.) A diminution in quantity. (2.) An increase of demand.

To a diminution of its value from —

- (3.) Increase of its quantity. (4.) A diminution of demand.

And as the same principles are true with respect to the other quantities as well, it appears that there are *eight* causes which may produce an alteration in the exchangeable relations of quantities. It is quite impossible to have stated the matter better and more comprehensively, than Lord Lauderdale has done. Ricardo admits* “this is true as regards monopolized commodities, and indeed of the market price of all other commodities, for a limited period.” If Ricardo had been properly trained in science, he would have seen that it is true of all commodities at all periods, and he would never have formed the erroneous system which he has done.

84. This doctrine of Ricardo's, that the laws proposed by Lord Lauderdale are true as regards monopolized commodities, and indeed of the market price of all other commodities for a limited period, which is also adopted by Mr. Mill, who says,† “Money is a commodity, and its value is determined like that of other commodities, temporarily by demand and supply, permanently, and on the average, by cost of production,” is a most manifest breach of the *Law of Continuity*. To say that at all other points in the range of prices, they depend upon one law, and at a single point upon a totally different law, is most plainly erroneous. Which is the exact point at which this change in the regulating law takes place? Because prices may approach very nearly to the cost of

* Principles of Political Economy and Taxation. Ch. xxx. p. 464. 3rd Edit.

† Principles of Political Economy. Vol. II. p. 10.

production, and yet differ. And where is the exact point at which this change in the law takes place? So that on the point on either side of it, we change from cost of production to supply and demand? But, in fact, we have shewn that in no two cases is the cost of production the same. It is perfectly plain that it is the law of supply and demand at every point, and at every time, and it is merely that, when competition is unlimited, the supply will be adjusted to the demand, so that price will usually average about the cost of production. If, as Ricardo admits, the prices of all commodities are at *all* times governed by supply and demand, what *other* times can there be, when they are governed by cost of production?

85. Dr. Whewell, gives an example of a breach of the law of continuity which is pertinent to the present case. He says,* "The Aristotelians made a distinction between motions according to nature, as that of a body falling vertically downwards, and motions contrary to nature, as that of a body moving along a horizontal plane; the former they held became naturally quicker and quicker, the latter naturally slower and slower. But to this it might be replied, that a horizontal line may pass by gradual motion, through various inclined positions to a vertical position, and thus the retarded motion may pass into the accelerated, and hence there must be some inclined plane, on which the motion downwards must be naturally uniform, which is false, and therefore the distinction is unfounded." The same fallacy is apparent in the doctrine of Ricardo's above quoted. There is no point at which the one law passes into the other.

86. A thorough apprehension of this Law of Continuity will be found to be of great importance in future parts of this volume, and Dr. Whewell's remarks are strikingly applicable.† "The evidence of the law of continuity resides in the universality of those ideas, which

* Phil. Ind. Sc., Vol. II. p. 413. 2nd. Edit.

† Ibid. p. 415.

enter into our apprehension of Laws of Nature. When of two quantities, one depends upon the other, *the Law of Continuity necessarily governs this dependence*. Every philosopher has the power of applying this law, in proportion as he has the faculty of apprehending the ideas which he employs in his induction, with the same clearness and steadiness which belong to the fundamental ideas of quantity, space, and number. To those who possess this faculty, the law is a *rule of very wide and decisive application*. Its use, as has appeared in the above examples, is seen *rather in the disproof of erroneous views, and in the correction of false propositions*, than in the invention of new truths. It is a test of truth, rather than an instrument of discovery." We merely quote this passage here, and shall shew its utility hereafter.

87. Now, these rules were completely applicable to the exchangeable relations of bullion and other commodities, while bullion was considered merely as a commodity. But when the conception of money was introduced, and bullion was the substance appropriated to the purpose of money, changes of a very subtle nature necessarily took place. Because bullion in the form of money was then appropriated to represent debt, and debts and the bullion which represents them, have exchangeable relations, just in the same way as any other two commodities. The chief purpose that gold bullion is put to, is to make money, and the use of money is to represent *debt*. Consequently, if the quantity of money always varies in exact proportion to the work it has to do, if it always varies exactly as the quantity of debt, no change in the value of money takes place whether its quantity be diminished or increased. On the other hand, if it does not vary in this proportion, a change will necessarily take place. Now, in former times, when industry was comparatively lethargic, and communication between places was slow and expensive, and even dangerous, there might very well be in one place a great accumulation of money without being able to diffuse itself over a

great extent of country, and a considerable diminution in its value might occur there. But even in those days, it is certain that a very great extension of industry took place in consequence of the importation of the precious metals from America. All authorities agree that the fall in the value of gold was by no means proportional to its increased quantity. J. B. Say says that the increase in quantity was twelvefold, but the diminution in value was only sixfold. And this diminution in value took a very long period to effect. At the present day there is no reason to fear any such result. Even supposing that the supplies of gold continue as plentiful from Australia and California, for a very long series of years as they are at present, the colossal commercial enterprise of the present age, will be able to absorb them all. The rate of interest at the present day shews the tension on Capital. In former times a diminution in the value of money would very soon manifest itself in a change of prices, because in those days, the owners of the gold kept it in their own possession, and exchanged it directly for commodities. But in modern times gold is not kept in the possession of private individuals, an unusual quantity of gold is sure to be deposited in Banks, and the manifest consequence of this is to cause a diminution in the rate of interest. In modern times, it is perfectly indisputable that the first effect of a great influx of capital is a great diminution in the rate of interest. This was particularly shewn in 1824, when the plethora of capital was so great, that the Scotch Banks gave no interest on deposits; again, in 1844, an immense accumulation of capital took place, and the discount on good bills fell to $1\frac{1}{2}$ per cent. Now, though no doubt a great increase of capital might ultimately affect prices generally, or the value of money, yet the first effects, by the modern system of trade, are to lower the rate of interest, but every lowering of the rate of interest at the present day, calls into existence immense quantities of enterprise. And even if there should be no employment for it in England, it is im-

mediately diffused over the continent and the whole civilized world. Every where there are gigantic enterprises ready to start into existence, the moment that capital can be had on reasonable terms; immense railway schemes throughout the whole civilized world, canals, steam navigation, &c.; new continents are rising into powerful empires; everywhere a demand for commercial enterprise; barbarous empires have to be civilized by railroads, and increased means of communication. Hence, not only is the demand for capital immensely increased, but the area of its diffusion is immensely extended. And the quantity of water which may produce a serious alteration in the height of a pond, will have no perceptible influence on a lake, or a sea. There does not seem, therefore, to be the least fear of the augmented supplies of gold from these quarters, however surprising they may be, producing any real alteration in the value of gold as money, though it is very possible, and we believe it to be actually the case, that the comparative value of gold with the other metal, which is extensively used for the same purpose, namely, silver, has undergone a variation.

88. Gold and silver being used in all civilized communities as the *measures* of value, it is not unusual for persons who are not sufficiently precise in their language to call them the *standard* of value. But this latter expression is certainly incorrect, as a standard means an invariable measure, which is capable of being defined and fixed, as the measure of length, weight, and time. These are capable of being fixed once for all, because they are certain portions of the quantities themselves; but value depends upon the ratio of quantities, which by the very nature of things it is impossible to control, and the actual alteration in the quantities of the precious metals has materially altered their value at different periods of history.

89. Many political economists perceiving that the precious metals could not be accepted as the standard of value, have endeavoured to discover some product which

might serve as a better one, and some of great eminence have selected wheat, but this will not stand the test of examination.

90. If wheat were allowed to bear its natural price, by which we mean its price when left to the free competition between buyer and seller, in the market of the world, it might perhaps lead to results of great interest and value. But with scarcely any exception the trade in corn has never been free and unfettered, either in England or in any country in Europe. Either there have been laws to encourage exportation or to prevent it, or to encourage importation or to prevent it, which have always exercised certain influences which it is absolutely impossible to ascertain, and yet which it would be necessary to disengage before we could set up wheat as a standard. An inspection of a table of prices of wheat for many hundred years will shew how unfit it is for such a purpose. In no article whatever are there such violent fluctuations in price either in long periods or in short ones. Wheat, moreover, is clearly a manufactured article; by skill and the application of science, wheat may be grown much cheaper in one place than another, and at one period than another.

91. It would be far too long to trace here the various alterations in policy which have taken place in England in the laws regarding corn. Since the year 1225, when the first law relating to corn was made, to 1846, when they were for ever abolished, about 150 Acts of Parliament were made for the express purpose of tampering with the price of corn. Many, if not most of these, did exercise some influence on its price, and it is chimerical to suppose that any one could pretend to state precisely what influence each one had in raising or lowering its price, and yet this must be done before we could arrive at a result of any value. And the same observations will apply to any other commodity whatever, the value of which changes in proportion to its greater or less abundance in comparison to the demand, or the various methods which may be discovered for diminishing the cost of its production, together with an unlimited supply.

92. Other writers of eminence suggest the wages of labor, as a surer standard, but this will be found upon investigation to be a more fallacious idea than the former. The wages of labor depend, like any commodity, on the demand and supply. The greatest possible difference exists between the rates of wages in different parts of the same country, and still more in neighbouring countries, and which of these is to be considered as the standard of the age? The wages of labor have risen greatly in most trades since the beginning of this century, and yet it is generally supposed that the currency was then more abundant, comparatively speaking, than at present, and the reason is clearly that industrial operations have so greatly multiplied since then.

93. These considerations shew that any attempt to fix upon a standard of value is quite hopeless, and that there are so many corrections necessary to be applied, which arise from artificial restraints, taxes, and a multitude of other causes, which utterly elude the grasp of the acutest intellect, or any possibility of testing their accuracy, that we may say with little hesitation, that such a thing as a standard of value has either no existence at all, or which is much the same thing practically, it is impossible to ascertain the necessary corrections which must be made before it can be settled. J. B. Say aptly says, that the attempt to discover a standard of value is the quadrature of the circle of Political Economy.

94. Since value depends entirely upon the ratio of demand and supply at any particular time, it is quite clear that it is wholly beyond the power of any law to fix the value of any one commodity as compared with any other, whether it be gold in reference to corn, or cloth, or wages, or anything else. These things were not properly understood in former times, and our early history is full of legislative attempts to fix the price of bread, beer, wages, and other commodities, but they all failed in their effect. As commercial ideas gradually advanced, these attempts were abandoned one after the other, and the last which

lingered was the attempt to fix the value of gold in reference to silver. In a subsequent chapter we shall trace the history of these regulations, which were only finally abandoned in 1816. After considerable variations, the relative values of these metals were fixed in 1717, on the report of Sir Isaac Newton, the Master of the Mint, at the denominations now in force, and the terms then really meant the price of one metal in reference to the other. Accidental circumstances combined during the greater part of the last century to keep this relation pretty steady, so as to conceal the faulty principle, till near the close of it, when their values underwent a great change. Soon after that the suspension of cash payments took place, and when they were restored in 1821, the true principle of having but one standard metal was in force. Since the year 1816, when this took place, gold has been the only standard currency of Great Britain, and silver is merely made into tokens for small change. It is true that the old expression of saying that the mint price of gold is £3 17s. 10½d. per oz. is still retained, but we shall see that it has wholly changed its meaning, and has no reference to silver at all. We shall see hereafter that it is of great use in testing the depreciation of the currency, but in its present meaning it is no violation of the principle we have noticed above. The ambiguous meaning of the word "price" in the expression has sometimes been overlooked, and warm animadversions been made on the supposed attempt at fixing the price of gold, as if the phrase meant the same thing now as it did when silver was legal tender.

95. We have before observed that the value of metals is always measured by their *weight*, and not by their quantity or bulk. The comparative value of gold and silver at present is about 15 to 1. The actual quantity of silver in use is supposed on the lowest estimate, to be forty times that of gold. But while its weight is more than 40 to 1, its value is less than 1 to 15 to that of gold. How is this difference to be accounted for?—by the rule

we have been discussing at so great a length,—the proportion of the demand to the supply of the two metals. Silver is far more extensively useful than gold. There are few persons in easy circumstances who do not possess more or less of solid silver plate, but such a thing as solid gold plate scarcely exists. What is called gold plate is only silver-gilt. Solid gold is only used for such purposes as watch-cases, or trinkets, such as chains, or pencil-cases, or brooches, &c. Silver, therefore, is in far greater demand for commercial purposes than gold, and it is this that raises its value to a higher proportion in comparison to gold, than we might expect from their comparative quantities by weight. It might no doubt be said that it is its very cheapness in comparison to gold that makes it more sought after, and the excessive dearness of gold that prevents it being used as extensively as silver, which is to a certain extent true. But the very cheapness of silver causes a much greater number of persons to be able to afford to have it than gold, and consequently the proportion to the demand for silver, compared to the supply, is greater than the proportion of the demand of gold to the supply; and it has the effect of raising the comparative value of silver as compared to gold.

96. The attempt to have a legal currency of both metals of unlimited amount, with a fixed relative value, is always liable to derangement from the excess of one or the other, so long as any one has the privilege of having an unlimited quantity of bullion coined into money. This inconvenience was repeatedly felt in England, when both metals were coined in unlimited quantities; but since 1816 this inconvenience has been obviated by the artificial limitation of the quantity of one metal in strict accordance with the formula we have given.

97. If we suppose any other substance to be used as a currency, the very same principles apply. However good or safe it may be in itself an excessive quantity necessarily and infallibly causes a diminution of its value. The paper currency of the country bears on the face of it a promise

to pay a given sum of money on demand. As long as a bank does not issue more of such promises to pay than it is believed to be able to fulfil, or than the trade of the district requires, they will circulate at their full value. But if it issues more than people think prudent, there will be a general disinclination to receive them at their nominal value, and the inevitable consequence will be that the holders of them will immediately go to the Bank and demand payment for them; or if it issues more than the trade of the district requires, they will be returned on it for payment. In either of these cases, therefore, so long as the Bank is solvent, and can pay its notes, a temporary over-issue has an immediate tendency to correct itself; the withdrawal of the excess of quantity of the notes will restore them to their par value, to the loss of the Bank, very probably, but still, if the Bank can bear the loss, the public will not suffer.

98. Suppose, however, while the Bank is notoriously wealthy and solvent, and has a considerable amount of its notes in circulation, they are suddenly declared to be *inconvertible*,—that is, the Bank is released from its obligation to pay its notes in money,—if the public agree to receive them in payment as before, while the same caution is exercised in issuing them as would be required if they were payable in money, they will still pass for their par value. But in this state they are to be considered as a distinct and independent substance—a currency of new material—just as gold and silver are, and they will follow the very same rules; that is, their value will depend upon the quantity of them which is issued. If while gold and silver are equally legal tender, and inconvertible with respect to each other, a very great increase in the quantity of silver takes place while gold remains the same, the silver inevitably diminishes in value, and a sovereign would pass for twenty-two or any greater number of shillings according to circumstances, supposing a perfect freedom in prices to be allowed by law. A tradesman would make a difference in the prices of his goods accord-

ing as he was paid in gold or silver. Thus, a shilling, instead of representing the one-twentieth part of a sovereign, would only represent the one-twenty-second part; and it is quite obvious that the difference between $\frac{1}{20}$ and $\frac{1}{22}$ would be the exact measure of the alteration in the value the silver currency had undergone compared with the gold. Now, an inconvertible paper currency is to be treated in all respects as an independent species of currency, like silver, and will follow exactly the same rules. No matter how good it is, or how wealthy the corporation be that issues it, an excess in quantity will infallibly cause a diminution in value. If the natural remedy of an excess of paper be withdrawn, namely, a power to demand payment for it, the excessive quantity will remain in circulation, and the very same result will follow as in the case of silver: it will diminish in value as compared with sovereigns. There will be two prices for articles—one when paid in gold and another when paid in paper—and the difference between the two will evidently be the measure of the diminution in value of the paper.

99. We have seen that the value of any article when sold by a private transaction between two individuals, is measured and determined by the relative circumstances of each. The price or general value between the seller and a larger circle of purchasers, is determined at a local market, and the larger and more open this is, the more nearly do we approach to the real value of the article. If there are many markets for an article, its price will of course vary according to the local circumstances of each, but it is quite clear that the more the means of transport are increased, accelerated, and cheapened, the more nearly will its value in the different markets be equalized, and if there be no artificial obstruction by law, or otherwise, to impede its being freely transported from one to the other, the difference in its value in different markets cannot much exceed for any length of time the cost of its carriage from one to the other. Hence the inevitable tendency of improving and accelerating the means of

transport is to equalize prices throughout the whole extent of country in which it takes place. Before the introduction of roads into a country, one province may be starving from a dearth of provisions, while in another, not far off, they may be so abundant as to be going to waste, while the expense of transporting them from one to the other may be so great as to make it impossible to do so. It is said that on one occasion in Spain, the inhabitants of one province were dying of famine, while in another there was a superabundance, and it was found cheaper to import corn from America to the starving province than from another part of the same country. Exactly in the same way the introduction of turnpike roads, and afterwards of railroads in England, has had the effect of raising the price of all sorts of agricultural produce in the distant counties, and depressing it in those near the metropolis, and the introduction of steam navigation has raised the rental of the remote parts of Scotland many thousands of pounds annually.

100. Since it is quite evident that the difference in the price of an article at any two markets can never, for any length of time, exceed the cost of conveying it from the cheaper to the dearer, it is also clear that the greater its intrinsic value is, *i. e.*, the greater its value in comparison to its bulk, the less can its difference in price be in any two markets, and the more uniform will its value be in all the markets of the world. Thus, diamonds, to which men have universally agreed to assign the highest value of any production, are nearly of uniform value throughout the world, owing to the facility of their transport, which bears so inappreciable a relation to their value. In times of great public danger, it is quite common for people to invest their whole property in precious stones. Precious stones, however, for many reasons which are too obvious to mention, are unsuitable to form a currency. Next after the precious stones, men have agreed to attribute the greatest value to gold, beyond any other existing substance, and from the same circumstance, gold bullion preserves a

greater uniformity of value throughout the world than any other substance, and the increased means, rapidity, and safety of transport, which now connect the nations of the earth, will continually tend more and more to confine the possible variations of its value within constantly decreasing limits.

101. We have already seen that the idea of a standard of value is wholly illusory, and is as impossible in the nature of things as the philosopher's stone, or the perpetual motion. Though gold bullion never can fulfil the impossible duty of being a standard of value of other articles, it is an infallible standard of measuring the value of what professes to represent it, namely, the currency of this country. Gold bullion, which is received in all markets, must necessarily be of more uniform value than gold coin, which passes in only one country. Coin can quickly be reduced into bullion, but to have bullion changed into coin is a comparatively slow and expensive process for any private individual. Hence, it is impossible that bullion can ever be really more valuable than coin, which professes to contain a certain amount of it, and if the price of bullion rises in the market above the value of the coin, which professes to contain a fixed amount of it, it is an infallible proof that the coin has sustained some diminution in weight or purity from the standard, or is depreciated.

102. We shall have occasion to discuss this latter point at much greater length, when we come to consider the nature and effects of a paper currency. In former times, when the means of transport were so much more unfrequent, slower, uncertain, expensive, and hazardous than at present, it was possible for gold bullion to undergo much greater variations in value, both in duration and extent, in different countries, and the severe penal laws regarding the melting or exportation of the coin of the realm, frequently caused an artificial difference between coin and bullion, hence the test we have spoken of was not so easily recognizable or so certain as now, but a long course

of the observation of effects in a particular direction, after making due allowance for other disturbing causes, may lead to results upon which reliance may be placed.

103. It has frequently happened in this country, as well as in every other in Europe, that the changes in the value of commodities indicated by their nominal prices in money have been only apparent and not real. The Sovereigns in former days attempted to multiply their resources by diminishing the quantity of bullion in the coin, while they retained its nominal value. The people, however, even in those times, were sharp-sighted enough to detect the fraud, and to counteract this depreciation of the currency they immediately raised the nominal prices of their goods, so as to insure receiving the same weight of silver. Thus the "pound," in days of William the Conqueror, actually was a pound weight of silver, and a shilling was the 20th part of a pound weight of silver. Repeated reductions were made in the weight of the pound, and at the present day it is coined into 66 shillings, so that, leaving out of consideration the diminution in the value of silver, from its greater abundance, the nominal prices of the present time must be reduced in the proportion of 20 to 66, or 1 to 3 $\frac{1}{3}$, before a just comparison can be made of the purchasing power of silver at these two periods. This is properly called a depreciation of the currency. But in addition to this, silver is unquestionably far more abundant now than in those days, and it has consequently diminished in value. So that we may say, that the currency is both greatly depreciated as well as diminished in value within the last eight centuries. Hence, in considering changes in price, we must always be careful to ascertain whether the change is real, which may be either through some alteration in the condition of production or demand of the article itself, or of the greater or less abundance of the precious metals; or whether it be only apparent and caused by a depreciation of the currency.

104. A certain relation having been established between the currency and the services, or industrial operations it

represented, their value would not alter so long as this proportion remained the same. But if either one or the other altered considerably in quantity, a change would take place in their value. In early times, when the precious metals were comparatively scarce, the different Sovereigns of Europe engaged in wars and other operations, which required a much greater quantity of money than they could readily command. In these difficulties they had recourse to the fraudulent plan either of diminishing the standard weight of the coin, or of making it of debased metal. Afterwards, when gold became more abundant, both gold and silver were coined into money. Pieces were struck to represent the assumed relative values of the two metals, but from a want of nicety and accurate knowledge of the subject, these two standards were always getting out of adjustment with each other, to the great detriment and annoyance of all who engaged in mercantile contracts. The inconveniences of a double standard were of too great importance to be continued in a mercantile country, and it being necessary to select one, gold was for various reasons chosen, and the danger of a scarcity of currency necessary for a due development of the industry of the country is obviated by the ingenious system of Bank notes.

105. Since the currency any one possesses is evidence of services due to him, it is evident that when he requires some of these services to be rendered to him, the arrangement of the price or the value of the service should be left entirely to the mutual agreement of the buyer and seller. Who can tell so well as they what is the real value of the service? Now, suppose that when the price of the service was so agreed upon and settled between the parties, some artificial force were suddenly put into the power of either of them, beyond what arose from their natural position, to enable one of them to compel the other to yield up more of his industry than he ought to do; such a force suddenly put into the hands of either party, whatever its nature be, whether moral or material, would clearly be unjust in its very nature, and it would be nothing more than a force enabling one party to rob the other.

day obtaining a greater influence in legislation, and many of the most striking and beneficial reforms of the present day have been to abolish and set aside the partial and unjust laws which encumbered the statute-book. It is not so very long ago that public opinion in this country tolerated, and men of eminent piety saw no harm in the slave trade, in stealing men from their homes and transferring them to foreign countries to labor for the benefit of their masters. But public opinion gradually became convinced of its abomination, and not only put it down, but declared it to be a great crime. What was considered to be legitimate traffic fifty years ago, is now declared by law to be piracy, and Englishmen who engage in it are liable to be dealt with as pirates. Now, there is not at bottom much difference in the idea involved in protection and the slave trade. They both seek to effect the same object by somewhat different methods. They are both for the purpose of enabling one set of men to appropriate to themselves the fruits of their neighbours' industry—the one by the coarser method of force, the other by the more refined system of fraud. Lord Macaulay remarks,* that the two greatest and most salutary social revolutions which have taken place in England, were those which in the thirteenth century put an end to the tyranny of nation over nation, and that which a few generations later put an end to the property of man in man. To these we may venture to add a *third*, not less great, and not less salutary than the other two—the great revolution in the ideas of the age which, in the nineteenth century, abolished for ever the property of one set of men in the *industry* of others.

109. The protective system is, therefore, nothing more than a method by which producers endeavour to force consumers to pay a higher price than they otherwise would for their commodities. Now let us consider a somewhat different case.

110. Suppose that the Legislature, being entirely

* History of England. Vol. 1., p. 22.

composed of consumers, should pass a law forbidding the farmers to sell their produce above a certain price, or to export it to foreign countries, where they might find a better market for it. Or suppose laws had been passed to prevent workmen from demanding above a certain rate of wages, or compelling producers to bring their productions to market, and accept a price for them much below what they would fetch if there were no such law. This would be a case on the part of consumers precisely analogous to what protection is on the part of producers.

111. This form of economic error never was sufficiently prevalent in this country to acquire a distinctive name in our language, but it did in France. During the height of the horrors of the French Revolution in 1793, when the insecurity of property had scared away almost all sorts of produce from the market, the French Convention passed the severest laws to limit the price of commodities, forbidding persons to sell their produce above certain fixed prices, whence they were called the laws of the *Maximum*. As might have been foreseen, these laws only aggravated the evil; and their disastrous effects are set forth with great minuteness in the 3rd, 4th, 5th, and 6th volumes of Alison's History of Europe (7th Edition), though the author overlooks the fact that the very same objections apply against the system of protection of which he is so strong an advocate.

112. Each of these systems, then, is erroneous, but in opposite directions; that of Protection, by which the producer obliges the consumer to buy from him his produce at a price above its intrinsic value; that of the *Maximum*, by which the producer is obliged to sell his produce to the consumer at a price below its marketable value. Now, every law whatever that interferes with the natural course of trade, which attempts to regulate the wages of labor or the price of commodities, which attempts to meddle with the free exchange of industry between man and man, must necessarily fall under one of these forms of error. Every such law sins against

natural justice more or less, in one direction or the other, and is an aggression of one party on the other, either as it assumes the form of Protection or the Maximum; and it is just as clear as the sun at noon-day that the only true, just, and proper course is to leave things to find their own level—or, in other words, to establish and maintain absolute freedom of trade.

113. The fact is, that both of these erroneous systems, both Protection and the Maximum, are forms of Socialism. For it is an interference with the free exchange of industry. And they are especially designed for the very purpose of interfering with the natural value of commodities. Consequently, whichever of the parties is able to compel the other to part with his commodities in a different proportion to what he would do if unconstrained, is able to appropriate to himself a portion of that other man's property. And this is the very essence of socialism. Protection is the Socialism of producers, the Maximum is the Socialism of consumers. And nothing is more natural than that where we find the one doctrine fashionable with the higher orders, the other will be popular with the lower. Of this we may see an example in France, where protection is the policy of the state, and socialism the creed of the people. In England there are, happily, few of either Protectionists or Socialists.

114. Now, the idea that was at the foundation of all this legislation was, that the cost of production should govern price, and that persons who produced articles had a right to have remunerative prices secured to them by law. This idea was a very natural one to occur to producers, and when we think of the condition of Parliament at the time when this species of legislation was in fashion, we shall not be surprised at its having prevailed. In the last century, it is true, there were at various times laws enacted for the purpose of disturbing the natural course of trade, but the corn-laws, which lasted with various alterations till Sir R. Peel so happily abolished them, were made in 1815. Now, what was the state of Parlia-

ment at that time? One branch was entirely composed, as it still is, of agriculturists; the other principally of agriculturists and the nominees of agriculturists, as well as great manufacturers, great merchants, great shipowners, and great producers of all sorts. It was entirely a Parliament of sellers—a vast, close, and corrupt combination. The great body of the people, *i.e.*, the consumers, had scarcely any influence whatever in the House of Commons. The sellers had a complete monopoly of law-making, and their legislation was exactly what might have been expected. All the producers in turn were permitted to plunder the public for their own benefit. It was nothing more than a gigantic conspiracy of all the sellers against all the buyers. Though these laws were intimately connected with currency, we cannot speak more of them, but they are a striking proof that no one man, nor can any single interest be entrusted to frame laws for the whole community in a spirit of justice, but to insure that, all interests must have a voice.

115. There is one case of Value, which may seem rather anomalous, and which deserves notice, as its principle is more extensive than may at first be supposed. If one were to go into a general exhibition of manufactures, one might chance to see a circular piece of glass about twelve or fourteen inches in diameter, and perhaps three inches thick. If an uninitiated person were asked what was the value of this piece of glass, he might perhaps think himself extremely extravagant if he were to answer two or three pounds. He might then learn to his amazement that the price of that common looking piece of glass was £1,200. It was intended for the object glass of a telescope. The reason of its enormous price is, that to be fit for this purpose, it requires to be of the most faultless purity. The slightest stria or bubble in it would render it useless. The difficulty of obtaining a glass fit for this purpose is so great, and the risk of accident through its various stages of manufacture is so great, that out of a thousand attempts perhaps only one succeeds.

The consequence is that the successful one must pay for all the expenses of the 999 failures. And, hence, what is intrinsically worth perhaps only a few shillings, cannot be sold for less than a thousand pounds. This probably is the most conspicuous instance of this principle, but it more or less pervades all trade. All traders are subject to make bad debts, and the losses they make must be distributed over their other business. Part of the price in all cases goes to cover losses by bad debts.

116. In treating of prices, we have carefully adhered to the most general form of expression possible, "service rendered," in order more clearly to keep in view, that a service rendered may be of very different natures, such as moral, intellectual, or material, all of which are measurable by price, and all of which are the producer's property.

117. In former ages, when people had scarcely emerged from barbarism, nothing was considered as property but *land*, which was solid and immoveable. As they became more civilized, and their ideas more refined, moveables were admitted to take rank as property: but still no property was held in regard but what was sensible to the eye and tangible to the hand. In process of time as refinement increased, men began to reflect that they had minds, and that their minds might be improved. Accordingly services rendered to the mind began to have value, and to be capable of being estimated in money. The way to render service to the mind is by communicating to it ideas, which convey to it perceptions of what is noble, and just, and true, and elevate the nature of what is really and truly the MAN. When men saw this in its proper aspect, they saw that a person who was capable of rendering services to them in this way, should be allowed to have property in his own productions, as well as the producers of material wealth. Hence, they recognised the right of man to have property in ideas. The law which gave men property in their own ideas, is called the law of *Copyright* or of *Patents*.

118. Just as the mind of man is admitted to be of a much higher nature than his body, so is the service rendered to his mind, of a much higher nature than one rendered to his body. Hence, ideas are much loftier species of property than material wealth. True ideas are the foundation of good government, and of the happiness and welfare of the whole human race, both here and hereafter; and it should be the object of every man to gather true ideas wherever and whenever he can, and follow them in practice. True ideas are the riches of the mind—riches, which neither moths can devour, nor rust corrode, which do not make themselves wings and fly away from us as an eagle, but which bear us like an eagle towards heaven—riches which some would have us believe we can take beyond the grave. And they are preserved and propagated in books “exempted from the wrong of time, and capable of perpetual renovation. Neither are they fitly to be called images, because they generate still, and cast their seeds in the minds of others, provoking and causing infinite actions and opinions in succeeding ages: so that if the invention of the ship was thought so noble, which carrieth riches and commodities from place to place, and consociateth the most remote regions in participation of their fruits, how much more are letters to be magnified, which as ships pass through the vast seas of time, and make ages so distant to participate in the wisdom, and illuminations, and inventions, the one of the other.”*

119. There is a peculiarity about the law of copy-right and patents, which is worth noticing. No man can have property in a general truth, or a principle, but only in a particular demonstration of the truth, or an application of the principle. No one can have a patent for a *discovery*, but only for an *invention*. As soon as a general principle is discovered, it becomes universal property, and every one can appropriate to himself any

* Bacon.—Advancement of Learning.

new demonstration or application of it he can devise. No man can appropriate to himself a scientific truth, nor can he have a patent for a principle; thus, he cannot have a patent for the general principle of the use of steam, or air, or electricity as a motive power, but only some particular form of its application.

120. Seeing, then, that the productions of a man's mind are now recognized to be as truly his own property and the fruits of his industry, as the production of material wealth, it is hard to see on what grounds he can be denied the same tenure in one as in the other. Surely no one can deny that a great work in literature is of as great a service to a country as a chair, or a table, or a ship; and yet the producer of one is not allowed to derive the same benefit from his services as the other. In the latter case, his right is acknowledged to be perpetual, and he may dispose of it as he pleases, and transmit it to his descendants as long as the thing continues in being; but the rights of the other are only transient, and after a certain brief period, by the existing law, cease for ever. The merchant who labors for commodities may found a family, and his descendants may be released for ever from the necessity of toil, through the wealth accumulated by their ancestor. But the descendants of the author, who may spend his life in producing a work which may adorn the literature, and be an everlasting possession to his country, may starve in the streets, while all the world may appropriate to themselves the profits made by publishing the works of their ancestor.

121. These things should not be. There can be no just grounds pointed out for the distinction; if an author's right in his own works exists at all, it exists for ever, and cannot be limited to 7, 14, 42, or any finite number of years; and just as the works of a Shakspeare, a Milton, or a Bacon, are a nobler possession for a country to inherit, than the most magnificent ship that ever floated on the ocean, so ought the rights of such a benefactor to his country to be preserved and guarded with as jealous

care, as those of the other, in any state where the rights of property are held sacred.

122. Mr. Macculloch, in his Commercial Dictionary, argues against the expediency of extending the present term of copyright, 42 years, and while he doubts that any advantage would accrue to authors, he thinks it would be detrimental to the public interest, and he instances a man computing a table of logarithms to five, or seven places, and says, that if his computations are correct, no improvement can be made upon them, to the extent at least to which they go; and he then asks, if he or his assignees are to be entitled in all times to prevent other persons from publishing similar tables, as an invasion of private property. Mr. Macculloch does not seem to be happy in his arguments on the question, and he is still more unfortunate in the instance he has selected to illustrate them, because a table of logarithms is a scientific truth, in which no one can have copyright, and is an instance of the exception stated in Section 119. The logarithm of a number, or of any other quantity, is a scientific truth or result, which every one is at liberty to calculate for himself in his own way, and if any one were to discover a new method of calculating logarithms, he would undoubtedly be entitled to copyright in that. But no one can have copyright in the actual result, any more than in any other scientific truth. Mr. Macculloch further states that in his opinion, more injury than benefit would result to literature from making copyright perpetual, but he gives no ground for such an opinion, and the benefit or otherwise to literature is wholly beside the question, which is, what are the *rights* of authors? The copyright of Clarendon's History of the Rebellion is the perpetual property of the University of Oxford, and there is a provision by statute, that all copyrights bequeathed to the Universities are perpetual; and we may well ask why the Universities should be permitted to have a perpetual copyright rather than an Author. The Universities evidently deem it an advantage to possess this property,

and the question is not the advantage of the public, but the rights of property. It would be an undoubted advantage to the public, and a great benefit to agriculture, if many of the gigantic estates in this country were broken up into smaller ones, and in the hands of more numerous and enterprising owners, but none but a few wild dreamers think of such an invasion of the rights of private property. Now, the right of an author in his own book is just as sacred as his right to his own land, and he ought no more to be deprived of one than the other.

123. The feeling of the law with respect to literary property, is very much that of the French Revolutionary tribunal. An elderly gentleman had been dispossessed of some old family property by violence during the revolution. He went to the court of justice to get them to expel the intruder. He pleaded that the property had been in his family for many generations, "Oh!" said the judge, "that is the very reason why I shall not give it to you back. Your family has had it so long, that it is right that some one else should have it now!!" So it is with literary property. The law thinks that 42 years is quite long enough for a man's family to enjoy the right of their own property, It is then some one else's turn to have it. In 1794, a notorious Scotch judge, Lord Braxfield, had no higher term to call men who held nothing but personal property than "rabble." The sentiments of the owners of material wealth towards authors is somewhat tinged with the same feeling. They meet with little sympathy from society in general.

124. The progress of public opinion evidently tends in this direction; something was done by the last Act, but the advancing voice of refinement, and the increasing perception of moral right, will probably demand more. Why should a man who devotes his life to carve out an estate in fame, be denied equal rights with one who seeks to agglomerate material wealth? Let us hope that the day is coming when the owners of the ideal ships that sail down the seas of time, freighted with the hoarded

treasures of the wisdom, and learning, and worth of successive generations, to illumine the understanding and gladden the hearts of the latest posterity, may enjoy, and transmit to their descendants, the same rights as the owners of the wooden and iron ships, which bring corn and cotton, and whatever else ministers to the material requirements of mankind.

125. The property we have already discussed at so great a length is all actually existing, but in all civilized countries there is property of a much more subtle nature, which has only a future existence, which has yet a present value, and may be bought and sold. And even the value of an immense quantity of existing property is calculated, not by what is visible and existing, but upon what is future. The most general name for this species of property, is that of the *present value of future payments*. The value of landed property is calculated by the annual rent it yields, and the rate of interest at the time of the purchase. The worth of landed property consists in its producing a regular series of stated annual payments for ever. Now, though each of these only falls due year by year in succession, each of them has a present value, and is capable of being bought and sold. And the value of the property is estimated by adding up this series of the present values of these future payments for ever. Now, the present value of a sum of money payable one year hence is such a sum of money as placed at the interest agreed upon would produce that sum. The present value of a sum of money payable two years hence, is such a sum as placed at *compound** interest, for two years, would amount to that sum. The present value of a sum of money, payable three years hence, is such a sum as placed at compound interest for three years would amount to that sum; and so on. Now, it

* The reader must observe that the Present Value of annuities is always calculated at *compound* interest; to do so at *simple* interest leads to an absurdity. Vide. Lund's Wood's Algebra. Art. 381.

is evident that this series of values diminishes very rapidly, till at length we come to one so infinitesimally small, that all after it may be neglected. And consequently the present value of the whole annuity for ever is the sum of these separate present values of each year. The number of terms in this series before we arrive at one infinitesimally small, depends entirely upon the rate of interest. The higher the rate of interest, the shorter manifestly will the series be. Although this is the strict way of looking at the matter, it would be a very tedious operation to calculate the present value of each term separately, and the practical result of the algebraical formula is very simple and easy. It gives us this rule simply. Divide the annual amount by the rate of interest and the result is the present value of the annuity. Thus, the present value of an annuity of £1 payable for ever at 10 per cent. is £10. At 5 per cent. it is £20; at 3 per cent. it is £33 6s. 8d.; at 2 per cent. £50; and each term in the series which makes up this amount has a separate value, quite independent of the money it will be redeemed with.

126. It is upon this principle that the value of all property which yields an annual rent, or which may be resolved into an annuity, is calculated. It comprehends all landed property, and all the public debt, besides an immense variety of rights of all sorts. And in a similar way, all future payments whatever have a present value quite separate from the money they will ultimately be paid in, and may be bought and sold like any other merchandize.

127. We have seen that each of the annual rents of a farm payable at a future time has a present value, which is bought and sold in the confidence that the future products of the farm will redeem it. Now, exactly analogous to this is the skill of a trader, it resembles the fertility of a farm, and as the future produce of the farm may be bought and sold, so the trader may pledge the produce of his future industry. He may

create a promise to pay at a future time; and that deferred payment has a present value, and may be bought and sold, exactly in the same manner as the deferred payment which will arise out of the expected produce of the farm. Upon this doctrine rests the whole system of mercantile credit. This property exists chiefly in the form of Bills of Exchange, and is of the enormous value of not less than £500,000,000 in this country.

SECTION II.

ON THE APPLICATION OF THE LAW OF PRICE TO CASES
OF THE PURCHASE FOR A LIMITED PERIOD OF THE
USE OF ANYTHING.

1. Having in the preceding section discussed the causes of the changes in price, where the entire and perpetual property of the commodity passes from the vendor to the purchaser, it remains for us to discuss it in those cases where the price is paid for the temporary usufruct of anything. This price receives different names according to the nature of the article whose use is purchased.

The word RENT is used when the commodity is land or houses, or mines, fisheries, forests, watercourses, or patents; *i.e.*, where the property is of the nature of what is generally *fixed capital*, or *real property*.

The word HIRE is used when the commodity is of the nature of what is usually *floating capital*, or *personal property*, such as furniture, horses, and carriages, &c.

The words WAGES, FEES, SALARY, PAY, are used in cases of personal services, such as laborers, servants, professional men, employés of all sorts, soldiers, sailors, &c.

The word INTEREST for the use of money.

2. Of all species of capital, land is the one which is most coveted, and whose owners are least able to superintend any considerable quantity, so far as regards value. Moreover it is a species of capital which seems sometimes to be very erroneously considered beyond the pale of commerce. Without entering into any historical account of how individuals came to be possessed of large quantities of land, it is well known that the ownership of the soil is in most countries in the hands of a, comparatively speaking, small number of persons. These are generally not in a condition, for many reasons, to work their capital, as manufacturers and other persons in commerce do, by the direct payment of wages to persons in their employment; but whenever the extent of their land attains any considerable size, they are in the habit of admitting other persons into a species of quasi-partnership for a limited period: and instead of receiving payment from the owner of the soil, they render certain dues to him for the use of the land. These dues may consist either in personal services, or part of the actual produce of the land, or a payment in money. In the eastern part of Europe the peasantry are allowed certain quantities of land for their own use, on the condition of giving a certain number of days' service on the lands of their lord. This species of service is termed *ROBOT*. In other parts of Europe the tenant pays to the landlord an actual portion of the produce of the land, usually the half, whence they are called *METAYERS*; and this formerly prevailed very widely in all countries where money was scarce. But in most civilized countries, this payment in kind has been commuted into a payment in money, and this is what is more properly termed *RENT*.

3. The term *RENT*, therefore, is applied to the share which the landlord receives of the profits accruing from the working of the land, as the interest of that species of capital. It is also applied to mines, fisheries, forests, water-courses, houses, and patents. It is also applied generally to the purchase for a limited time of the use

of such property, even when no profit is intended to be made, as in the case of dwelling-houses, houses in the country, shooting grounds, &c. Hence, rent only arises when the property in question is lent out to some one. When the owner of the article uses or works it himself, there is no such thing as Rent, any more than when a man trades with his own money, can there be any such thing as Interest.

4. When one person agrees to collect a certain revenue, paying a certain fixed sum to the landlord, or owner, and retaining all the surplus for himself, he is said to **FARM** that revenue, and is called a **FARMER**. Thus, it was formerly the custom in England and in France, up to the time of the revolution, to farm the taxes: that is, capitalists agreed to give the government a fixed sum, and they were then allowed to collect all the taxes for their own benefit. This system being applied to the cultivation of land, the quantity of land, by a perversion of language, so lent out, came to be called a *farm*, and to *farm* came to mean to cultivate the land. A good farmer has come to mean a person who is a skilful cultivator of land; and by a grotesque confusion of ideas a gentleman who cultivates his own land is called a gentleman-farmer:—the only proper meaning of which phrase can be, a gentleman who lends out his own land to himself, and pays himself a rent for the use of it. By a somewhat similar contortion of idea the word premises, which really means the “aforesaid things,” has come to signify a house.

5. In the case of the metayer system, the quantity and the value of what the landlord receives, varies from year to year, according to the harvest, and the price of the produce. But in countries where the more perfect system of Rent prevails, it is more generally usual for the farmer to contract to give a definite fixed sum for the use of the whole farm to his landlord, which does not fluctuate according to the variable prices of produce. Having paid this, the farmer has all the rest of the value to himself, whether it be much or little.

6. To many persons it appears an inequitable arrangement that the tenant should pay a fixed sum to the landlord, whatever be the price of corn, which is notoriously an article whose value is of the most fluctuating description. And no doubt to persons who are not much acquainted with the subject, the metayer system may appear to be more equitable. But it is not found to be so in practice. Payment of rent in kind used to prevail to a considerable extent in Scotland. In many parts of the country there are still to be seen large buildings, in which the farmers used to store the rents of the landlord. But the unfortunate landlord of course got the worst part of everything. And as civilization advanced this payment of rent in kind was universally abolished, and a payment in money substituted. Now, as the people have universally abandoned a payment in kind, and substituted a payment in money, it is the best proof that can be had that the latter method is more practically convenient than the other.

7. But even though the payment in kind of a portion of the produce has been abandoned, and the payment made in money, many schemes have been devised to ensure what appeared to be a more equitable division of the profits between landlord and tenant, according to the varying price of corn. And different modifications of this system, which is generally called "corn rents," are in favour in this country. It is necessary to observe the distinction between the system of Metayers, and corn rents. The former is a division of the actual produce of the soil between landlord and tenant, the latter is a payment in money, but varying according to the price of corn. While, in some parts of this country, opinion is much in favour of corn rents, on the other hand, in many other parts of the country which are in the highest state of cultivation, and where the highest science prevails, corn rents are held in utter abhorrence, and opinion is equally tenacious of fixed rents.

8. At the first blush of the thing it might appear

that corn rents were manifestly the most equitable. To this we say, that so many different systems have been proposed, that it is impossible to give a general answer. Some that have been proposed can be clearly shewn to be most unfair. To give, therefore, a proper answer we must have the particular system that is proposed. But our own observation leads us to doubt whether these corn rents are so advantageous as is frequently supposed. In the first place, as agricultural science improves, the greater is the variety of the products of the farm, and the greater is the complexity of accounts required to calculate the rent. Besides, we believe that it will be found that there will be less variation in the value of the whole produce of a farm, than in its quantity. When the quantity is great, the price will be low, when the quantity is small the price will be high, consequently the total money value will probably be more steady from year to year than the whole quantity. And it will be found that farmers in general, at least those of substantial capital, who are most desirable to have as tenants, prefer to have a fixed charge once for all, which they know beforehand, and which they can calculate upon, than a varying one.

9. From the entirely erroneous views propagated by Adam Smith and Ricardo, as to the cause of value, *i. e.*, supposing that labor or cost of production is the cause of value, one of those vermicular discussions has arisen, namely, whether rent is a component part of price or not. And much controversy has been expended upon this unprofitable discussion. Rent comes out of price, and that is all that can be said.

10. Rent, however, may be increased by increasing the quantity produced, even though the market price does not vary. The improvements of agricultural science, such as draining, manuring, the rotation of crops, &c., may, up to a certain length, increase the quantity produced in a very much greater ratio than the expenditure of capital. And this is manifestly equivalent to diminish-

ing the cost of the production of the whole. Diminution of the cost of transport has also the most material effects upon agricultural prosperity. Thus, rents may be increased even though the average price is not increased, or is even diminished.

11. We have in the preceding section shewn that taking all the requisites for producing corn, *i. e.*, placing it in a given market, we may suppose that there is a regular series of gradations of the cost of production of agricultural produce in different places. Hence, the profits, or the difference between the cost of placing any quantity in that market, and the sum actually received for it, must also vary in a series of regular gradations, till they diminish to nothing. Accordingly as the rent paid by the tenant is paid out of these profits, there must be a descending scale of rents payable out of the price realized till the quantity of rent vanishes, or no rent can be paid.

Now, we have seen in the preceding chapter, that the ratio of supply and demand regulates the market price, and the market price regulates rent.

12. Now, if a country is very well peopled, and thickly studded with markets, it may be that all the land in it can be let at a good rent. But if we suppose it of indefinite extent, and only partially occupied, it is quite evident that in the descending scale, we shall arrive at some land in which the circumstances are so unfavourable, that is, the cost of production is so great, that it will only just be possible to cultivate it with a profit, and beyond that, any cultivation beyond what may be necessary for the actual wants of the persons living on it, must cease. The point where this will occur purely depends upon the circumstances under which profit ceases. If prices rise, or the cost of production is diminished, the land under more unfavorable circumstances may be brought under cultivation; if the price falls, or the cost of production is increased, then a certain portion of the land already in cultivation will be abandoned.

The result of all this is, that the average price of corn regulates the most unfavorable circumstances under which corn can be produced, or it regulates the greatest cost of production that can be bestowed in producing corn, and it also regulates the most unfavorable circumstances under which rent can be paid, and the amount of rent in all cases.

13. Such is the whole theory of rent, which is plain and simple enough. But we must now notice the Theory of Rent advocated by Ricardo, and which bears his name, though he does not even pretend to have originated it. We only do this on account of the exaggerated importance which has been attributed to it. It has been called the "*pons asinorum*," and the corner-stone of Political Economy, with what justice we shall see.

14. Ricardo begins by defining rent to be that portion of the produce of the earth which is paid to the landlord for the use of the *original and indestructible powers of the soil*.* The Romans held it to be an evil omen to stumble on the threshold. Any one who has the slightest knowledge of agriculture can see at once that Ricardo's definition of rent is absurd. The earth has no "original and indestructible" powers in the sense he means. The only original and indestructible power that it has, is that of *extent*. There is scarcely any land whatever which is fit for cultivation without a very considerable expenditure of labor or capital, and the powers of the earth are so far from being indestructible, that except in a few favored regions, they wear out very fast, and require a constant renewal of labor and capital to keep it in a fit state for cultivation. He then says, "It is often, however, confounded with the interest and profit of capital, and in popular language the term is applied to whatever is annually paid by a farmer to his landlord. If, of two adjoining farms of the same extent, and of the *same natural fertility*, one had all the convenience of *farming buildings*, and besides, was properly drained and manured, and advantageously divided

* Principles of Political Economy and Taxation. p. 53.

by hedges, fences, and walls, while the other had none of these advantages, more remuneration would naturally be paid for the use of one, than for the use of the other, yet, in both cases, this remuneration would be called rent. But it is evident that a portion only of the money annually to be paid for the improved farm, would be given for the original and indestructible powers of the soil; the other portion would be paid for the use of the capital which had been employed in ameliorating the quality of the land, and in erecting such buildings as were necessary to secure and preserve the produce." With respect to this, we may say that rent is the word invariably applied to remuneration paid for the use of houses and buildings, and therefore nothing can be more proper than to include the sum paid for them in rent. With respect to the other things which are necessary for the due cultivation of the farm, to deny to the name of rent to the remuneration paid for them, is as frivolous as to say, in speaking of a house, that the word rent is to be restricted to the sum paid for the use of the bare walls, but that the remuneration paid for the painting, papering, fitting-up, and all the decorations, is to be called interest for capital.

15. Ricardo then says, "Adam Smith sometimes speaks of rent in the strict sense to which I am desirous of confining it, but more often in the popular sense in which the term is usually employed. He tells us that the demand for timber, and its consequent high price in the more southern countries of Europe, caused a rent to be paid for forests in Norway, which could before afford no rent. It is not, however, evident that the person who paid what he calls rent, paid it in consideration of the valuable commodity which was then standing on the land, and that he actually repaid himself, with a profit, by the sale of the timber. If, indeed, after the timber was removed, any compensation were paid to the landlord for the use of the land, for the purpose of growing timber, or any other produce, with a view to future demand, such compensation might justly be called rent, because it would be paid for

the productive powers of the land; but in the case stated by Adam Smith, the compensation was paid for the liberty of removing and selling the timber, and not for the liberty of growing it."

This objection of Ricardo's is manifestly of no weight, because rent is in all such cases part of the profits of the produce of the soil, and the distinction made between the remuneration paid for the right of cutting that timber, and the right of growing future timber, is manifestly futile, because though the sum paid for that single crop is limited, it is manifestly paid for the use of the productive powers of the earth, so far as regards that crop, just as much as the future produce of the productive powers of the earth.

16. Ricardo then goes on, "He speaks also of the rent of coal mines and of stone quarries, to which the same observation applies—that the compensation given for the mine or quarry is paid for the value of the coal or stone, which can be removed from them, and has no connection with the original and indestructible powers of the land. This is a distinction of great importance in an inquiry concerning rent and profits, for it is found that the laws which regulate the progress of rent, are widely different from those which regulate the progress of profits, and seldom operate in the same direction." The objection taken by Ricardo to Adam Smith, has no force whatever. The fact is, that his own definition of rent is purely arbitrary and futile. It is a matter of utter impossibility to distinguish the portion of the remuneration which is paid for the use of the *original and indestructible* powers of the soil, and the portion which is paid as interest of capital expended upon it. To do that strictly, all the labor which has been expended upon bringing it from a state of nature must be called capital expended upon it, and the remuneration paid for that must be subtracted from the rent. And then what will remain for rent? The fact is, that the separation of rent and profit, as proposed by Ricardo, is a thing that cannot be effected, and is nothing more than a play upon words.

17. Having thus proposed a definition of rent which is highly incorrect, Ricardo then goes on to explain how rent arises. He says that on the first settling of a country in which there is an abundance of rich and fertile land, a very small proportion of which is required to be cultivated for the support of the actual population, or indeed can be cultivated with the capital which the population can command, there will be no rent. For no one would pay for the use of land, when there was an abundant quantity not yet appropriated, and therefore at the disposal of whosoever might choose to cultivate it any more than he would pay rent for the use of air, and water, or any other of the gifts of nature, which exist in boundless quantities. It is only, then, because land is not unlimited in quantity, and uniform in quality, and because in the progress of population, land of an inferior quality or less advantageously situated, is called into cultivation, that rent is ever paid for the use of it. "When, in the progress of society, land of the second degree of fertility is taken into cultivation, rent immediately commences on that of the first quality, and the amount of that rent will depend on the difference in the quality of these two portions of land. When land of the third quality is taken into cultivation, rent immediately commences on the second, and it is regulated as before by the difference of their productive powers. At the same time the rent of the first quality will rise, for that must always be above the rent of the second, by the difference between the produce which they yield, with a given quantity of capital and labor. With every step in the progress of population which shall oblige a country to have recourse to land of a worse quality to enable it to raise its supply of food, rent on all the more fertile land will rise."

18. To the preceding paragraph it would be difficult to raise any objection, except that in no case at all can rent arise unless land is let by a landlord to a tenant. But as invariably happens when persons start with a false conception of the very nature of their subject, although

they may go on a little way with apparent correctness, yet when they proceed to develop their views, they are sure, ultimately, to involve themselves in error and confusion. So it is in this case. Ricardo proceeds, "rent is always the difference between the produce obtained by the employment of two equal quantities of capital and labor." "Rent invariably proceeds from the employment of an additional quantity of labor with a proportionally less return;" and he then immediately proceeds to say, "When land of an inferior quality is taken into cultivation, the exchangeable value of raw produce will rise, because more labor is required to produce it," and that it is the quantity produced under the most unfavorable circumstances that regulates price, of which proposition we have shewn the entire fallacy in the preceding section.

19. Pursuing a similar train of error, he says,* "The reason why raw produce rises in comparative value, is because more labor is employed in the production of the last portion obtained." "The value of corn is regulated by the quantity of labor bestowed on its production on that quantity of land, or with that portion of capital, which pays no rent." But immediately afterwards, with that curious mixture of truth and error which pervades the whole of the exposition, he says, "Corn is not high because a rent is paid, but a rent is paid because corn is high; and it has been justly observed that no reduction would take place in the price of corn, although landlords should forego the whole of their rent. Such a measure would only enable some farmers to live like gentlemen, but would not diminish the quantity of labor necessary to raise new produce on the least productive land in cultivation." This observation of Ricardo's is perfectly just, but it is unfortunately at variance with the rest of his system.

20. We shall find that the rent of land is an excellent example of the rule we have established for determining

* Principles of Political Economy and Taxation, p. 63.

instantaneous value. The rent is the money paid by the farmer to the landlord for the use of the land. The first indispensable condition of rent arising is, that one person is the owner of more land than he can conveniently cultivate himself. A landlord is a capitalist whose capital consists of land; and like all other capitalists, he either trades with it himself, or lets part of it out to others to trade with, and of course he is entitled to receive interest for the use of his capital like any other capitalist. The difference between a landlord who cultivates his own land and a farmer, is just the difference between the man who trades with his own, or on borrowed capital. A man who has a large amount of capital in land is in a very different position to one who has his capital in money, because no single man can trade with any very large amount of land. It is very rarely a man farms more than a thousand acres of land, but many a merchant trades with half a million of money. Now, unless a man can trade with his land himself, or get some one else to do so, it is of no value to him; but if the merchant cannot trade profitably with half a million of money, it will still be useful to him—he can always get some interest for its use, however small. It is, therefore, a positive necessity to a man who possesses a large estate, to let part of it out to farmers. No misfortune to a large landed proprietor could be worse than to have a considerable extent of his estate thrown upon his hands at once. Now, this circumstance increases the power of the person who wants to borrow the capital, over the one who wants to lend it; it is a greater service done to a landlord to take a farm, than it is to a tenant to let it to him. In this case, like as in other loans of capital, we must consider the farmer as the purchaser of the service; but when the capital to be borrowed is land, the power of the purchaser over the seller is much greater than when it is money. Hence, we must expect that the price of it should necessarily be lower; and this is what we actually find to be the case. The rent of land, or the money paid for the use of that species of capital, is much

less than in the safest mercantile operation. There are, no doubt, other causes which also tend to produce a similar effect, operating simultaneously to increase the difference; but the cause we first assigned is a true cause of a certain amount of that effect, though not of the whole of it. The rent of land rarely exceeds $2\frac{1}{2}$ or 3 per cent. of the value of the land, and is often less than that.

21. Having thus shewn that the average amount of the interest of the species of capital which consists of land, must in general be less than the average amount of the interest of capital in the form of money, we must now consider how rent arises at all, and show that the actual amount of it in any particular case conforms to our rule. If we suppose the produce of the farm, carried to market, and realized in money, it is evident that the first charges upon it are the public burdens, which the state requires by way of taxes, the farmer's own living, the cost of all the laborers and animals upon his farm, and the cost of conveying it to market. When all these necessary and preliminary charges are deducted from the price realized, the remainder is the fund which provides for the landlord's rent and the farmer's profits. The proportion in which this fund is finally divided is settled by our rule. But the tenant has a stronger natural position than the landlord. The landlord has a very strong necessity to let the farm, the farmer has no very strong necessity to take it, and if he is unable to gain a fair profit by doing so, he has more resources open to him to employ his capital in, than the landlord has. Hence, when the farmer's profits and the landlord's rent come into collision, the landlord's rent must give way. The inherent strength of the tenant's position must, therefore, in the long run, prevail over the landlord, and, hence, we see why it is that the price of corn determines the rent.

22. The sum which the farmer has to pay as rent is included in the total cost of production, and it will be determined exactly in the same way as the price of any

other service, by assigning a proper value to each quantity in our formula. We have already shown that it will in general be lower than the money paid for the use of any other kind of capital, because the power of the purchaser over the seller is greater than usual; but if there be many competitors to purchase the service, the power of the seller over each of them will increase, and this will raise the price of the service. That is to say, if there be many competitors for the farm, the rent given for it will be greater than if there are few.

23. From these observations we gather that the farmer is just in the same position as the manufacturer; neither of them can command the price they please for the articles they have to sell; consequently they must each consider what will be the probable value of it when sold, and then they must devote the whole of their skill and energy in diminishing the cost of production. In order to do this each of them calls in the aid of science; the manufacturer in the mechanical form of machinery, the farmer in the chemical form of manures and draining, and every other means that science or skill can suggest to develop the productive powers of the earth. Neither of them can fix absolutely what the cost of production is, until every improvement in science has been adopted, and every resource exhausted. It is undoubtedly true that the cost of production and the value of the produce must have a relation to each other, but the question which is to govern the other is the whole difference between protection and free trade. Under the former system, the cost of production might be as extravagant and wasteful as possible; the land might be undrained and badly cultivated, and the object was to secure by law a price which should under all circumstances, cover every conceivable piece of waste and bad management, which was, with somewhat of a *mauvaise plaisanterie*, called the *natural* price of corn. While the one system held out a direct reward for every species of mismanagement and ignorance, and stinted production, the other, on the contrary, en-

courages skill and energy, and stimulates production, and so confers upon the community at large the blessings of as great abundance and cheapness as circumstances permit.

24. Our formula at once explains a fact which is well known to every one who has practical acquaintance with the management of estates, that it is far more advantageous for a landlord to have his estate divided into farms of moderate size than very large ones, because so many more persons have a moderate than a large quantity of capital, and consequently so many more are able to compete for a moderate sized farm than a large one. The landlord being the seller of the service, his power over each competitor increases according to their number, and he can demand a higher price for it. But if a farm is very large, so few can compete for it, that the landlord's power over each diminishes, and he will usually be obliged to let it low. The same remark holds good in houses, and for the same reason; houses of a moderate size let much better than those of a large one.

25. Having said thus much concerning Rent, there is nothing to detain us on the subject of *Hire*, which is the sum paid for the temporary use of what is usually floating capital, or personal property, except this, that the sum paid for its use must include two elements, one the ordinary profits of the capital invested in the article, and the other to represent the deterioration of the article by wear and tear, so that when it is worn out, the total sum received must be sufficient to replace the article, and to give the necessary profits to induce production. In every particular case, the sum paid will follow the law of supply and demand, but no deviation from the general level of profits can long occur, because objects which are the subjects of hire are so easily and quickly produced, that if any extraordinary profits are made, competition quickly reduces profits to their lowest remunerating level.

26. We now come to the cases of personal services

of all descriptions, which is a very extensive branch of our subject, and which will be found to be complete examples of the general law we obtained in the preceding section. That rule shows why the wages of a skilful workman are so much higher than those of an ordinary one, because the work being of better quality, it is a service of greater intensity, and the skilful workmen being comparatively few, the employer is more restricted in his choice, and so his power over them diminishes, and he must yield to their terms to a certain point. But if he were to go beyond a certain point, he knows very well that the value of the article when produced will not be sufficient to cover its cost of production and the necessary profits, so rather than exceed that point, he will not produce the article at all. On the other hand, the skilful workman must live, and he knows that the employer cannot give beyond a certain price, and he is obliged to yield rather than starve; so these circumstances determine the rate of labor or wages. But if the number of skilful workmen increases, he has greater power over them, and the wages of their labor fall. Thus, it is universally observed that when some new invention comes out, the article produced is high in price, because so few can produce it, and so many require it; as soon, however, as it becomes better known, and more can produce it, the price of it falls, though the workmanship is in no whit inferior, and this is because there being more competitors for purchasers, the power of the purchaser over each of them increases.

27. It was a doctrine long maintained, even by respectable writers, that the wages of labor were in proportion to the price of food, but there never was a more fallacious idea. Burke said that the Norfolk squires had dined when they gave it as their opinion.* If the wages of labor depended upon the price of food, it would necessarily follow that the wages of all trades

* Thoughts and Details on Scarcity. Works; Vol. II. p. 248. Bohn's Edit.

should rise and fall together. But it is notorious that such is not the case, for it frequently happens that while one trade is enjoying great prosperity, another is greatly depressed. It is often remarked that those towns where a great variety of trades are carried on, are most uniformly prosperous, because the probability is that if one trade is doing badly, others are doing well, and it seldom happens that all trades are simultaneously depressed, whereas those towns in which only one trade is carried on, are subject to alternate fits of great prosperity and great depression. The wages of labor, however, in each trade are determined by the circumstances of that particular trade, though it is often the case that particular circumstances may affect several different trades simultaneously.

28. So far is it from being true that a rise in the price of food causes a rise in the rate of wages, that the effect is generally the reverse, and a rise in the price of food depresses wages. When the community at large has to pay an enhanced price for their food, which is an article of prime necessity, they have less to spare for clothing and other goods. These being less sought after, will diminish in value, consequently as the manufacturer cannot get so much for his goods, he must either diminish the cost of their production, or cease to produce. He must either force down wages, or shut up his mills. So that the necessary result of a considerable rise in the price of food is a fall in wages. That this is the case in manufacturing districts is too notorious to be disputed. Now, the wages of labor in this case depend entirely upon the relative necessities of the workmen and the employers, and their relative power over each other. The workmen will of course resist a fall in wages as long as they can, but if the master cannot reduce them to a certain rate, he cannot repay himself for his outlay, so that if the workmen refuse to work for those wages he must shut up his mill; but if the workmen cannot find employment they must starve, so they must at last consent to the master's

terms. On the other hand, when there is a good sale for the master's productions, he is anxious to supply this demand and realize profits, and the workmen soon find this out and refuse to work unless for higher wages, but in this case there is also a limit which the master cannot go beyond, and there he takes his stand as before, and the workmen must yield. It sometimes happens that the workmen are so misguided as to think that by increasing the price of their labor they can force up the market value of the article, which erroneous idea has given rise to a great number of unhappy proceedings, so well known as "strikes," in the manufacturing districts. These strikes have repeatedly happened, both when trades have been in a state of great depression, as well as when they were prosperous; in the former case, when the masters found it necessary to reduce wages, the men combined to resist the reduction; in the latter case, when the men combined to raise their wages, and the masters resisted them, so that the men struck to compel the masters to yield. From these examples, as well as others which will be adduced, it will be seen that instead of the cost of production regulating the value of an article, it is frequently its value which determines the cost of production.

29. Hence, we see that wages, or the price of labor, are determined by the value of the service at the time it is rendered. If there is a great demand for goods, there is a great demand for men to make them, and every master who has orders to execute is anxious to engage men to enable him to do so, and the inevitable consequence of this is to give the men a greater power over their employers, and enable them to raise their demands, and the masters can well afford to do so, because though by the rise of wages their profits upon each individual transactions may be diminished, yet from the greater number of operations, their profits are increased upon the whole. On the contrary, when the demand for goods falls off, and the quantity of the work to be done is diminished, there are so many workmen to do it, that each is anxious to

secure a share of it for himself, and then the power of the masters increases over the men, and they are enabled to reduce wages, nay, they *must* do so in self-preservation, because the number of their operations being reduced, the profit on each must be increased, to enable them to live. Now, when is it that the demand for goods increases? Common sense and universal experience reply, when the price of food is low, for then the people are able to indulge in other luxuries, and give a spur to labor. On the contrary, when food is high they have less to spare from food, which is an absolute necessity to them, and they must curtail their expenditure on other articles, so that there is less demand for labour, and in the natural order of things, the price of it falls because the power of the laborers is diminished. The history of prices in this county will be found to confirm the truth of these observations, never was the price of labor so high as when food was cheap, on the contrary as food rose the price of labor fell. These fluctuations in wages, produced by causes which were ill understood, alarmed and irritated the workmen, and opened an unfortunate field for a number of designing knaves to prey upon their ignorance and misery.

30. It is not surprising that ignorant and uneducated workmen should fall into this mistake, when we see persons of much better education commit precisely the same error. The fundamental error which brought about so many of these unhappy strikes was, what has been said by persons of repute, that the cost of production of an article regulated its price. Many of these strikes were the nothing more than the attempt to carry out to their practical and logical conclusions the doctrines which eminent political economists had enunciated with applause. The workmen thought that by combining to raise the price of their labor they could force up the price of the article. But these proceedings have invariably ended in failure and disaster to their authors, for they neglected to take into their calculation the necessity the public had

for the article, and their means of supplying themselves with it elsewhere, which are essential elements in determining the price.

31. It is no doubt true that there is a limit below which the wages of labor cannot fall for any permanent time, and which is determined by the price of food, but this only relates to the very lowest, rudest, and most unskilled species of labor, and even that limit has happily never yet been reached in England, because it depends upon the lowest, cheapest, and worst kind of food capable of supporting man. The poorest laborer in England has now wheaten bread to eat, such as probably, in the mediæval ages, for which there has been lately such a ridiculous enthusiasm, a nobleman could not obtain. If such bread as is usually consumed in many a nobleman's house on the continent were given to the inmates of an English workhouse, it would infallibly cause a riot. The lowest class of laborers have fortunately never been reduced to such a point continuously, though it may sometimes happen that when work is scarce, they can earn very little, and then they may be driven to receive relief from public or private charity, which takes them out of the operation of the law of supply and demand. It is also universally observed that when the price of bread rises very high, the wages of the lowest class of laborers never rise in any like proportion. The way of raising the wages of labor, then, is not by raising the price of food, but by diminishing the number of competitors for it, for it is the number of competitors compared with the quantity of work to be done, that influences the price of labor, and not the variation in the price of food.

32. It is no mere speculative opinion that a general and long-continued low price of corn is not only not necessarily accompanied by a low rate of wages, but most probably by the very reverse. The most remarkable continuance of generally fine seasons and abundance of corn ever known occurred in the last century. For the extraordinary period of sixty-five years, from 1701 to

1765, there was, with a few exceptions, a continued series of plentiful harvests. The average price of corn for that period was 16 per cent. less than the average price for the preceding century; but notwithstanding that, the price of labor rose greatly during the same period, and, what was least to be expected, *agricultural labor rose 16 per cent.* Mr. Tooke says,* “The fact, indeed, of a rise of money wages in this country, coincidently with a fall in the price of corn during the long interval in question, rests on unquestionable authorities;” and, says Adam Smith, “In Great Britain, the real recompence of labor, it has already been shewn, the real quantities of the necessaries and conveniences of life which are given to the laborer, has increased considerably during the course of the present century (*i. e.*, the 18th). The rise in its money price seems to have been the effect, not of any diminution of the value of silver in the general market of Europe, but of a rise in the *real price of labor* in the particular market of Great Britain, owing to the peculiarly happy circumstances of the country;” and, “The money price of labor in Great Britain has indeed risen during the course of the present century. This, however, seems to be the effect, not so much of any diminution in the value of silver in the European market, as of an *increase in the demand for labor in Great Britain arising from the great and almost universal prosperity of the country.*”† In the latter part of the century, the price of wheat rose enormously in consequence of a long succession of bad harvests, but there was no corresponding rise in wages.

33. Mr. Ricardo says,‡ “Labor, like all things which are purchased and sold, and which may be increased or diminished in quantity, has its natural and its market price. The natural price of labor is that price which is

* History of Prices. Vol. I p. 55.

† Wealth of Nations. Book I. ch. xi., Vol. II. p. 91. Wakefield's Edition.

‡ Principles of Political Economy and Taxation. 3rd Edition, p. 86.

necessary to enable the laborers one with another to subsist and perpetuate their race, without either increase or diminution." "The natural price of labor depends on the price of food, necessities, and conveniences required for the support of the laborer and his family. With a rise in the price of food and necessities, the natural price of labor will rise; with a fall in their price the natural price of labor will fall." "The market price of labor is the price which is really paid for it, from the natural operation of the proportion of the supply to the demand; labor is dear when it is scarce, and cheap when it is plentiful. However much the market price of value may deviate from its natural standard, it has, like commodities, a tendency to conform to it." A little examination will shew how vague and inaccurate the ideas in these sentences are. What are the *natural* food, necessities, and conveniences of a laborer? The standard varies in every country. Are we to take the wheaten standard of England, the oaten standard of Scotland, or the potatoe standard of Ireland? or the black rye bread standard of Poland? Which of these is the *natural* standard? Wages in the West Riding of Yorkshire used to be 14s., in Dorsetshire 7s. a week, which of these was the *natural* standard? A little reflection will show that the idea of a natural standard is a mere chimera. The same principle determines the rate of wages in each of these cases; it is the proportion existing between capital, employment, and laborers in each locality. What made wages so low in Ireland and Dorsetshire? The abundance of laborers, and the scarcity of capital and employment. What made wages so high in Yorkshire? The abundance of capital and employment, and the scarcity of laborers. If any cause produces a change in the relative proportions of these three elements, a change in the rate of wages necessarily results. Since the famine and emigration have relieved Ireland of the superabundance of laborers, wages have risen greatly. Emigration has produced the same effects in Dorsetshire, and if the same proportions as now exist

~~As soon as these three elements be preserved, the ordinary~~
~~market price will continue as at present.~~ We see, then,
~~the necessity~~ ~~unnecessury~~ of speaking of the natural price
~~in labor.~~ What Mr. Ricardo means by the natural price
~~is nothing~~ more than the usual market price, which has
~~been produced~~ by a long-continued steadiness in the pro-
~~portion~~ between the elements of wages, but if any causes
~~change~~ that proportion, the ordinary market price changes
~~with it.~~ Hence, we see that the relation of supply and
~~demand~~ is the sole rule that governs wages.

It will be seen that Ricardo's views on the subject
of labor, are influenced by exactly the same error, which
is the fundamental defect of his doctrine of Value, namely,
an inversion of cause and effect. It is perfectly manifest
that it is not the price of food which regulates wages,
but the wages received which indicate the most expensive
food which the laborer can afford to buy. Wages in
England have not risen because the laborers eat wheaten
bread instead of rye bread as formerly, but they eat
wheaten bread because their wages enable them to do
so. The wages in Ireland were not so low, because the
people eat potatoes, but the miserable peasantry were
driven to feed upon potatoes, because their wages were
so low, because there were so many laborers and so little
employment. So the people in Scotland eat oatmeal
porridge and oatcakes, because their wages were not
sufficient to allow them to eat wheaten bread. Just for
the same reason in the northern districts they used to
wear kilts, because they were too poor to wear better
clothes. But since they have become better off, they
dress like their southern brethren, and they eat wheaten
bread to a very much greater extent than formerly. And
so it is on the continent of Europe. The people in a
great many of the continental countries live so badly,
because their wages are so low. There are so many
people, and there is, comparatively speaking, so little
employment. Nothing can shew more clearly the error
of the idea that the price of food regulates wages than,

on the one hand, the case of the United States of America and Canada, where food is extremely cheap, and wages extremely high. What is the reason of this? It is that food is very abundant, and labor very scarce. It is nothing but the supply and the demand of each article. On the other hand, we may take as a reverse case, the example of the unfortunate needlewomen of London and other cities of western Europe. Garnier remarks* exactly the same thing of the needlewomen of Paris. "*A Paris par exemple tout le travail d'aiguille est tombé à un taux insuffisant pour faire vivre celles qui n'ont pas d'autre ressource.*" And Dr. Mayer says that at Lille the workwomen who make the lace gain from 1d. to 1½d. a day, working 16 hours. And population has increased so much compared to employment, that those who could gain two or three francs a day 30 years ago, in 1845 could gain only one franc, and those the most favored. At the other extremity of the world, we may take China as an example of the same truth. Travellers give us accounts of the disgusting garbage which the poorer Chinese will eat: now, the rate of wages there does not depend upon what they eat, but they are driven to eat that abomination, because the remuneration for labor is low. And this is on account of the prodigious numbers of the people.

35. The law of supply and demand, then, holds universally with regard to wages. An excessive increase of the people forces down wages by an inevitable law of nature, and as their numbers increase faster than employment, their wages must progressively diminish, and their comfort and scale of living become rapidly deteriorated. Nothing could save the scale of living of the poorer classes in this country from descending to the level of the Irish, or the Chinese, if their numbers went on increasing without a corresponding increase of employment. It is not unusual to hear persons of benevolence, who

* *Elémens d'Economie Politique.* p. 404.

see the shocking misery, which even now prevails among so many in this country, exclaim that employers ought to pay higher wages. But all such ideas are visionary. There is only one effectual mode of relief, and that is to diminish their numbers, by providing outlets for the superabundant hands, until the diminution of their numbers may again raise their wages, so that they can find constant employment, at wages which will enable them to live in comfort.

36. The greater part of Adam Smith's chapter on "Wages and Profits in different employments,"* is a curious example of the same inversion of cause and effect, and a consideration of the phenomena detailed in it, will afford a further indication of the truth of the preceding principles. He says that there are five principal circumstances which make up for a small pecuniary gain in some employments, and counter-balance a great one in others:—

1. The agreeableness or disagreeableness of the employments themselves.
2. The easiness and cheapness, or the difficulty and expense of learning them.
3. The constancy or inconstancy of employment in them.
4. The small or great trust which must be reposed in those who exercise them.
5. The probability or improbability of success in them.

These considerations of Adam Smith have been very generally approved of, and have acquired some celebrity; yet it is quite easy to show that they are all reducible to the general law we have arrived at, and that in some of them Adam Smith has most manifestly inverted cause and effect.

37. When he says that the wages of the more agreeable trades are lower than the disagreeable ones, the reason is

* *Wealth of Nations.* Book I., Chap. x.

very plain. Persons in general prefer the most agreeable trades, consequently there are more competitors for employment in them; but there is also a necessity for disagreeable trades as well, and higher wages in them must be offered to tempt workmen to embark in them. These causes are manifestly to be referred to the law of supply and demand, the various degrees of desirability of the different trades, being merely the circumstances which influence the relation of supply and demand.

38. In the second case, Adam Smith has most manifestly inverted cause and effect, and his ideas are pervaded with the radical error of his system. After enumerating several species of business, he says, "Education in the ingenious arts, and in the liberal professions, is still more tedious and expensive. The pecuniary recompense, therefore, of painters and sculptors, of lawyers and physicians, ought to be much more liberal, and it is so accordingly." A very slight consideration will shew that it is exactly the reverse of what Adam Smith says. The rewards of lawyers, doctors, &c., are not high because their education is expensive, but they expend much on education because the rewards are high. There is no better example of the truth of the principle we are contending for, and of the fallacy of the one we are combating, than these cases. There is, probably, no difference whatever in the expense of the education of the most able and the least able doctor or lawyer; but there is a prodigious difference in the result, owing chiefly to the differences in the innate capacities of men, and the success or the contrary will in general depend upon the qualifications of each man; the quality of the result, and not upon the cost of its production. We shall, however, consider these more fully under the last case.

39. The third case is also manifestly reducible to the law of supply and demand, just as the first is, because men naturally seek for constant employment rather than precarious employment, consequently they will crowd

into one more than into the other. And the employers in the trade in which work is less constant, must necessarily give higher wages than those in which it is more constant, to attract persons to it. Exactly in the same way, in places of trust, the qualities which fit persons for such employments are comparatively rare, and unless a high price be offered, it is not likely that the employers will find a suitable person.

40. The last cause which, according to Adam Smith, influences the wages of labor, is the probability or improbability of success in the employment. In considering this case, this celebrated author has suffered himself to be led away by one of the most curious instances of misanalogy anywhere to be met with. People speak figuratively of life being a "lottery," and of the uncertainty of success in it. Adam Smith, seizing upon the word *lottery*, has been led away into a most curious fancy, which has also deceived some later writers. "The probability that any particular person shall ever be qualified for the employment to which he is educated, is very different in different occupations. In the greater part of the mechanic trades success is almost certain, but very uncertain in the liberal professions. Put your son apprentice to a shoemaker, there is little doubt of his learning to make a pair of shoes; but send him to study the law, it is at least twenty to one if he ever makes such proficiency as will enable him to live by the business. In a perfectly fair lottery, those who draw the prizes ought to gain all that is lost by those who draw the blanks. In a profession where twenty fail for one that succeeds, that one ought to gain all that should have been gained by the unsuccessful twenty. The counsellor at law, who perhaps at near forty years of age, begins to make something by his profession, ought to receive the retribution, not only of his own so tedious and expensive education, but that of more than twenty others who are never likely to make anything of it. How extravagant soever the fees of counsellors at law may sometimes

appear, their real retribution is never equal to this. Compute in any particular place what is likely to be annually gained, and what is likely to be annually spent by all the different workmen in any common trade, such as that of shoemakers or weavers, and you will find that the former sum will generally exceed the latter; but make the same computation with regard to all the counsellors and students of law in all the different inns of court, and you will find that their annual gains bear but a very small proportion to their annual expenses, even though you rate the former as high, and the latter as low as can well be done. The lottery of the law is, therefore, very far from being a perfectly fair lottery, and that as well as many other liberal and honorable professions, is in point of pecuniary gain, evidently under-recompensed."

41. No one who really examines the foregoing ideas can fail to see their utter incongruity. In a lottery, the chances of each individual who ventures in it are absolutely equal; no personal qualification can influence his chance in any way whatever; the greatest simpleton may draw the greatest prize, the wisest man may draw a blank. In many cases it may be certainly predicated of an individual who adopts a profession, whether he will succeed or fail, and success in all cases is the result of personal qualifications. In a lottery it is perfectly well known that only a certain number can by any possibility succeed, and all the rest must necessarily fail. In a profession it is quite a matter of possibility that all may attain success, and it is also a matter of possibility that none may attain success sufficient to enable them to live. To carry out Adam Smith's analogy, we might just as well say that poetry is a lottery, and that the sum paid to the good poets should recompense all the waste of time by the bad poets.

42. It is quite evident that the fees of counsel are simply examples of the law of supply and demand. Nothing can be more erroneous than the idea that the fees are high, because the education is high. The truth

is, that people spend much money upon a professional education, *because* the rewards are so high; and the rewards are so high, because they are of so great importance to mankind, and because great skill in them is so comparatively rare. The fees of a Follett, or a Dunning, or a Scott, were not so high because there were so many Mr. Brieflesses, but simply because the talents of a Follett, or a Dunning, or a Scott, were so rare and so important. If their talents had become more general, the rewards of their labor would have diminished. It is exactly the same law in the other professions alluded to. It is the high rewards that may be won in them, that attracts high talent into them, and it is for the sake of these high rewards that men undergo a long, tedious, and expensive education, and course of labor. Exactly as the Roman tribune said.

43. Having now considered the cases of rent, hire, and personal services, we now come to the question of Interest. When a man employs his own capital in trade it is perfectly clear that he is entitled to retain for his own use all the profits resulting from such operations, whether those profits be twenty per cent., one hundred per cent., or a thousand per cent. If any one of superior powers of invention were to employ his capital in producing a machine, which should be of great public utility, he might realize immense profits and accumulate a splendid fortune, and no one in the ordinary possession of their senses would grudge such a man any amount that he might legitimately make, or would think it inherently wicked of him to gain as much as he could; on the contrary, he would probably be applauded, he would be called a benefactor to his country, and his name would be handed down with honor to posterity.

44. It often happens, however, that persons endowed with such powers of mind and habits of industry as would tend to enrich themselves and benefit their country, are deficient in capital, or the means of setting their industry in motion. On the other hand, it often happens

that persons who possess capital, or the latent power of setting these energies in motion, are deficient in the active qualities which are necessary to give it effect, or they may not have the necessity or inclination to do so. Under these circumstances it is manifestly advantageous to all parties, and the community in general, that those who have skill and industry without capital, and those who have capital without skill or energy, should meet together and combine their respective latent qualities. Such a combination would produce a beneficial result, and it seems clear that each party should have the profits of the combined enterprise in some previously agreed proportion. Such operations are extremely common, and there are two methods usually adopted as to the sharing of the profits. The person who advances the capital may either agree to receive a certain definite proportion of the profits realized, or he may stipulate to receive a certain definite sum in proportion to the capital advanced. In the former case he agrees to share the risk of there being no profit at all, or he becomes a *partner*. In the latter case he restricts his share to a certain amount previously defined, however large the profits may be, but he endeavours to shield himself from any loss which may arise, and in this case the sum he receives as a reward or hire for the use of his capital is called INTEREST.

45. The price to be paid for the service rendered by the capitalist does seem to be entirely a subject for private arrangement between the parties, just as much as the price paid for any other service; nor does there appear to the eye of common sense anything in the nature of things inherently wicked in any particular division of the profits they may agree upon between themselves. The service rendered by lending money in such cases may vary in intensity according to circumstances, just as any other service may vary. Nobody thinks it wicked for a man to make 1000 per cent. of his own capital if he can do so; nay, those who do so are frequently looked upon as the greatest benefactors to mankind. But if one

person borrow capital from another, and give him a price for the service rendered, or a share of the profits in proportion to the capital advanced, it appears to some people to alter the whole nature of the transaction. While a return of 30 per cent. was quite an ordinary return in the way of trade for a man's own capital, they thought it something essentially wicked for the person who advanced the capital whereby these profits were made to take more than 5 per cent. for the use of it. The above is a simple explanation of the nature of interest; and there certainly seems no imaginable reason why such a contract should not be left to the private arrangement of the parties themselves as other contracts usually are. Yet there is no subject upon which men seem so utterly to have taken leave of their senses as on that of interest or usury. Dante punishes usurers worse than those who denied the existence of the deity, and puts a whole city famous for its monetary business into hell, as a companion to the cities of the plain. Nor is it possible to say whether the nonsense talked by Dante, or the nonsense talked by Aristotle on the subject of usury, is the greater. And it is not a little humiliating to think, that within the last twenty-three years it was a crime punishable by law to take more than 5 per cent. for the use of money in any case whatever, and that the usury laws were only partially relaxed then, and were not finally abolished till 1854. And in the most modern works on Banking published in France, the other eye of Europe, it is still deemed necessary to retain a chapter on the lawfulness of interest.

46. Supposing, however, the rate of interest to be free and unfettered, as it now is, it is very easy to see the considerations which will govern it. In the first place, as the interest is always a part of the profits realized, it is clear that the first element which will determine it will be the expected rate of profit. The next is the proportion between capital and industry. If capital be very scarce, and those who want to borrow it numerous, they of course

will naturally give a greater proportion of the profits to the capitalists. But if capital be abundant, and those who want to borrow it be fewer, the capitalists will have to be contented with a smaller proportion of the profits, and the rate of interest will fall. These considerations shew at once that interest conforms to the rule we have already established for prices, for the profits expected to be realized by means of the capital are the intensity of the service rendered; and the number of those who want to borrow compared to the quantity of capital to be lent, represents the power of the buyer over the seller. Hence, interest varies directly as the profits, and inversely as the proportion of the supply to the demand, which, thrown into an arithmetical form, is:—

$$\text{Interest} = \frac{\text{Profits.}}{\frac{\text{Supply.}}{\text{Demand.}}}$$

$$\text{Or, Interest} = \frac{\text{Demand} \times \text{Profits.}}{\text{Supply.}}$$

47. The preceding considerations shew that the Interest of money is precisely analogous to the Rent paid by a farmer to a landlord. They are each of them paid out of the profits realized, and they are the hire paid by the borrower for the use of trading capital, and they generally bear some proportion to the profits, but what proportion that will be, is modified by particular circumstances in each case.

48. These considerations contain the general principles which govern interest under ordinary circumstances, but of course, in times of great commercial difficulty, both general and particular sums are paid for the use of money very much higher than the usual rates, which are also called interest; but these are exceptional cases, and are paid, not out of the legitimate profits of business, but for some great exigency, as for the use of sums for a short time to stave off ruin, or other penalties which may attach to a trader for failing to meet his engagements.

The sums paid in such abnormal instances are not fairly to be called interest.

49. Let us consider a practical example, in order to put the matter in a clearer view. Every one who is acquainted with agriculture knows how profitable it is to drain and improve land. In many districts, draining land pays 30 per cent., that is, it will repay the whole sum laid out upon it in a little more than three years.

50. Now, let us suppose that a farmer has an improvable farm, and wants capital to improve it; he goes to a capitalist, and tells him that by laying out £1,000 upon it he can increase the value of its produce to the amount of £300 a year. Now, if the capitalist and the farmer agree to combine in this operation, and agree that the extra produce obtained by that expenditure should be shared between them in certain proportions, why should any other person, or why should any law interfere to decide what that proportion should be? Why should it not be left to themselves to settle upon the price of this service rendered, just as the tailor and the customer agree between themselves upon the price of a coat, or anything else?

51. If the case were stated as above to any man of ordinary intelligence, and he were asked in what proportion the extra produce should be shared between the capitalist and the farmer, he might very naturally answer, that it would be fair to have it *equally* divided. Now, if we suppose the operation performed and the produce actually obtained and shared equally between them, every one would commend so equitable a bargain. But suppose that instead of the produce being shared equally in kind, it was previously sold, and its value in money obtained, then it would appear that the capitalist received 15 per cent. for his money, and this, in the estimation of a very general prejudice, which flourished till very recent times, would alter the whole nature of the transaction, and the capitalist would be branded with very opprobrious epithets, and subject to severe punishment.

Now all this folly arose from a misconception of the elementary principles of interest.

52. We are happily relieved from entering into any discussion of the Usury Laws by their being at length totally exterminated from our Statute Book. But we may be permitted to observe that the progress of just legislation on this subject must always be remarkable as an instance of the extraordinary *vis inertiae* of an established law in this country, where no great popular passion is brought to bear on it, even where no great interests are enlisted in defending it, and where abstract justice and good sense are not made a popular cry. In the year 1691, Locke published his "Considerations of the Consequences of Lowering the Interest of Money," in which the futility of the Usury Laws was perfectly demonstrated. The letters of Bentham upon the "Defence of Usury" are as splendid examples of unanswerable argument as any in existence. The most eminent writers had pointed out, not only their utter futility to effect their purpose, but their highly mischievous effect in aggravating the evil they were intended to prevent. The experience of several commercial crises had demonstrated, that in consequence of the law attempting to prevent people paying more than 5 per cent. for the use of money, they often had to pay 50, 60, or 70 per cent. by the methods they were forced to adopt. They were investigated and condemned by a Parliamentary Committee. Yet it was only in the year 1833 that the first breach was made in them, by exempting bills which had not more than three months to run from their operation, and by temporary extensions and prolongations, most other contracts were taken out of their operation, but it was only in 1854 that they were finally swept away from the Statute Book. Thus, from the period of their total demolition in argument till their total demolition in fact, a space of not less than 161 years elapsed. If it took this period to abolish laws equal in absurdity to those of witchcraft,* and which were felt and

* The last trial for witchcraft in Great Britain took place in 1736, the last case of Usury in our law books was in 1856.

acknowledged to be an unmitigated nuisance by great numbers of the community, we may well believe that it will take 20 years* to introduce the decimal system of coinage, which might cause a little inconvenience to a few people for a week or so, but which would be an enormous saving of time to the whole commercial interest.

53. In the example we have taken of improving land, we have seen that the first expenditure of £1,000 would produce a return of thirty per cent. on the outlay, and therefore a profit of fifteen per cent. would be by no means an inequitable sum for the capitalist to receive. It would by no means follow that the outlay of another £1,000 would produce an equal profit, and in fact it would almost certainly not do so, consequently, the person who advanced a second £1,000 to be expended upon it, would not receive so large an amount of interest as the first, if the same rule were followed of sharing the profits equally, and with the expenditure of every successive £1,000, the profits would be less and less, till at last they would be inadequate to produce any appreciable return on the capital. In all these cases, however, the rate of interest paid for the use of the capital would be modified by the quantity of capital that was to be had, in comparison to the quantity of it which was wanted to be borrowed. From these circumstances we may see why the rate of interest will usually be much higher in a new country than in an old one; first, because the expenditure of a like sum of money will generally produce a greater profit in a new colony, than in the old country; and secondly, in a new country the quantity of capital in it will be necessarily small, because the community has not had time to render those services to mankind, which are the only means by which they can accumulate capital. When an old country throws off a swarm of colonists, it is most generally caused by physical suffering at home. People do not generally desert their ancestral home, unless they

* The opinion of Sir John Herschell—which seems too sanguine.

find that their means of advancement are circumscribed, and that they can get no adequate reward for their industry. A new colony will therefore abound with energy and industry, but be deficient in capital, which will make a greater comparative demand for it, and necessarily raise its value, or the price paid for the use of it. In old and highly developed countries, interest will necessarily be low, because there will usually be a great store or accumulation of capital, the fruits of centuries of industry and parsimony, which is transmitted from generation to generation, and as few people wish to diminish their capital or property, there will be a considerable demand for investments by capitalists, and they will by their competition have to submit to lower interest. A consideration of these modifying circumstances will be found to be in exact accordance with the formula we established for prices in Chapter II.

54. We must also observe, that though rent and interest are analogous in their nature, so far as they are each the remuneration paid for the temporary use of a species of capital, yet they proceed in opposite directions in the progress of society, the reason of which is very obvious. In an early stage of society, land is very abundant, and food is very abundant, consequently when every one can buy land for himself, he will not hire any, and even if he does, the rent must be very low, because the price of food out of which rent comes is very low. On the other hand, capital or money is very scarce, and there is a great demand for it as well as for labor, consequently wages and interest will be very high. But as population and wealth increase, the land becomes more scarce, and the demand for food increases, which raises the price of food. There is less land to be sold, and its price is much higher, consequently many persons who prefer that mode of life, and cannot afford to buy land, are obliged to hire it and pay rent for it, and as the price of food increases, rent increases too. On the other hand, each successive generation adds to the accumulation of capital; the number of persons

increases, and this especially as profits, so naturally diminish. The fact is, that these money, are subject to interest of society. The demand for the supply, the supply of the demand.

interest rates which permanently govern interest in different countries; but in market rates of different species of interest rates vary from time to time interest rates; but yet they will all be found the general rule.

the question we have hitherto not the danger of the security, but we investment to be perfectly safe; and it and received for the use of the money of the security of the investment interest. But almost all subject to more or less risk, and the sum denomination of interest must include the actual hire for the money, and the of insurance on the risk, and just as greater, so must the premium be higher. found to be exactly analogous to rent or Chapter I. It was there seen that the any article comprised two elements, one capital invested in it, the other to replace or wear and tear of the article itself. losses in trade may be considered as or wear and tear of capital. And the use of money in a particular employment similar way, comprehend one element for the profits and the other sufficient to cover the usual and risks of that mode of investment. If one is more hazardous than another, it is quite clear that no capitalist will lend his capital to that employment

unless he receives in the long run enough, not only to give the profits of capital, but also to cover the losses and replace the wear and tear, or deterioration, of capital. Hence, the rate of interest will always rise in proportion to the risk of the security, and hence there must always be in the same country, and at the same time, a different market rate of interest for every investment of a different degree of security, just as there is always a different rate of hire or rent for articles of different degrees of perishability. But these different rates will always rise and fall together.

57. We may look at the question in another light. Lending out money at interest may be regarded as the purchase of an annuity, to last for a longer or a shorter period, according to the agreement of the parties. Hence, in purchasing such an annuity, the price of it has to be considered just in the same way as the price of anything else. Now, it is quite evident that the value of the annuity must, in a great measure, depend upon its certainty of being paid, or upon its security; and if there be one species of security more certain than another, it is quite clear that the former is a service of greater intensity than the latter; and must be paid for accordingly. Thus, we may say, that a person who offers to take money at interest wants to sell an annuity to the lender of money, and just in proportion as the security he can offer is good, so will he get a higher price for it; so that the interest of money paid by the borrower will be just in proportion to the risk run. Thus, money may be lent to merchants, to landowners, or to government. Now, merchants are always subject to unforeseen disasters, not only from their own speculations, which may turn out unfortunate, but they are usually so involved with others that they are always liable to suffer from the faults or misfortunes of others; consequently there is always some risk in lending them money. The owner of land is exempt from many of the risks a merchant is exposed to; he is not generally involved with others in his business, but his

prosperity is based upon the land itself, and, as long as that is judiciously managed, it gives forth a sure increase, unless under the effects of some temporary dispensation of Providence. Consequently the security for the payment of an annuity based upon the increase of the earth is far greater than one which is liable to the casualties of commerce. A considerably higher price, therefore, will generally be given for an annuity whose security depends upon land than upon commerce, that is, a landowner can usually borrow on cheaper terms than a trader. The Government of this country, again, is considered to be more secure than either land or commerce; consequently, by the same rule, an annuity purchased from the Government should usually cost more than either of the two former ones. And this exactly corresponds with the fact; the interest obtained by investing money in the funds is usually lower than what is obtained either from mortgage on land or on mercantile security.

58. We may, therefore, consider that the price paid for the use of the money always includes these two elements, one of which is the fair earnings of the money itself, and the other is the insurance to cover the risk of the loan to the lender. Each of these varies at different times, according to the particular person to whom the money is lent, and the total effect will vary accordingly, and it is sometimes not easy to discriminate the effects due to each separate cause.

59. These, then, are the circumstances which determine the relative market rates of interest on different species of security in any country, at the same time. If the rates of interest be observed at any particular time, the difference arises solely from the difference in the estimated safety of the species of security. And it will also be found, that if the rates in the same species of security vary, it is because there is more danger than usual in the particular security offered by an individual. Thus, in the species of security offered by Governments, which are usually called funds, the price of an annuity of £3 a year

from the English Government, is seldom much under £100, while no one would give more than £30 or £35 for a similar one, from the dishonest and bankrupt Government of Spain. That is, the English Government can borrow money at little more than three per cent., while the Spanish Government can scarcely do so at nine. The same may be said in a greater or less degree of every one of the European Governments, and the prices of annuities to be paid by them, vary exactly in proportion to the supposed honesty or capacity of each to fulfil its agreements. It is universally true, that the value of the different kinds of annuities at the same time, and in the same market, will vary exactly in proportion to the estimated security of each. But this is by no means the case, if the observation be made at different times, because the value of money itself changes from time to time, like that of any other commodity, and accordingly the price paid for its use will vary according to that value, so that the interest received from the most secure species of investment at one time, may exceed that usually paid for the least secure species at another time, and this difference in value will be caused by an alteration in the relation of supply and demand, in accordance with the general principles that govern price. Thus, when commerce is stagnant, or there is a superabundance of money that cannot find employment, the competition for lending it increases, and the power of the borrower increases over each lender. On the other hand, when commerce is active, there are more persons who wish to borrow, and of course the price will rise in proportion to the increase in the demand, and this will cause a rise in the market rate of all securities.

60. When this general change takes place in the market rate of interest, it by no means implies that the securities are more dangerous at one period than another, but only that money itself has risen in value, and the different species of securities will preserve the same relative differences as before.

61. A fall in the rate of interest is so far from proving the safety of the security, that it will frequently be found to be worst, when interest has been much depressed below the usual rate. Because when that happens, all sorts of wild schemes and speculations are set afloat, partly on account of the undue facility of obtaining capital, and partly because when interest is so much depressed, there are so many persons who live upon the interest of their money who become so distressed by the diminution of their incomes, they are tempted to embark in all sorts of hazardous schemes which promise a better profit. All the great commercial crises of late years have been preceded by a continued and unusual depression in the rate of interest. On the other hand, when it rises much higher than usual, it puts a stop to a great deal of legitimate business in a manner that is very injurious to the country. It is clearly, then, most for the public advantage that the interest of money should neither be so low as to tempt persons to embark in dangerous speculations, nor so high as to impede real and useful industry.

62. The rate of interest in the whole market is affected by the alteration of the ratio of supply and demand. The whole class of seekers which constitute the demand is composed of a great many different branches, and if there be a great demand for money in one of these subdivisions, it will affect the rate in the whole market. One of the most important, if not the most important, of these subdivisions is the demand for money for mercantile discounts, and an alteration in the ratio of supply and demand in this branch always causes the most important effects in the whole market. But while we may say that an alteration in this ratio will produce these effects, we are not yet in a position to consider the causes that produce the alteration, until we fully understand the credit system, upon which our commerce so greatly depends, which will be treated of in the next chapter. We have seen that the rate depends very much

on the most sensitive of all feelings—*confidence*, and it is clear that an Act of Parliament is as incompetent to regulate that as it would be to govern the changes in the barometer. We are, however, happily saved the trouble of demonstrating the unmitigated mischief of usury laws, by their recent abolition.

63. The expression, value of money, being applied to the purchase of two distinct species of articles in commerce, namely the ratio which a given quantity of money bears to a given quantity of commodities, and also to the price of debts, which is measured by the discount, has given rise to some considerations of a somewhat subtle nature, which we must endeavour to unravel. We have shewn that the rate of interest, or discount, depends upon the quantity of debts offered for sale compared to the quantity of capital to buy them with, just in the same way as the exchangeable relations of money and commodities are found to be influenced. It might appear therefore at first, that a great increase in the quantity of the precious metals which leads to a diminution of the value of money with respect to one of these articles of commerce, should also necessarily lead to a diminution of the value of money in respect to the other. That is to say, for instance, if the value of money were so diminished with respect to commodities, that it required double the quantity of bullion to purchase any given commodities, that the rate of interest or discount ought to fall to one half. And conversely, that if there was such an increase of capital that the value of money diminishes so much in purchasing debts, that the rate of interest, or discount, fell to one half, that therefore the quantity of bullion necessary to purchase commodities should be doubled. It would appear that such an idea that the value of money should diminish to one half with respect to commodities and remain the same with respect to discount, was paradoxical, and self contradictory.

64. Accordingly Adam Smith says,* that several

* *Wealth of Nations*. Book II. Chap. IV.

eminent writers have maintained that the increase of the quantity of gold and silver in consequence of the discovery of the South American mines, was the real cause of the lowering of the rate of interest, through the greater part of Europe. Those metals they say, having become of less value (*i. e.*, of less purchasing power with respect to commodities) themselves, the use of any particular portion of them became of less value too, and consequently the price which should be paid for it. Adam Smith says, "The following very short and plain argument, however, may serve to explain more distinctly the fallacy which seems to have misled those gentlemen. Before the discovery of the Spanish West Indies, ten per cent. seems to have been the common rate of interest through the greater part of Europe. It has since that time in different countries sunk to six, five, four, and three per cent. Let us suppose that in every particular country, the value of silver has sunk precisely in the same proportion, and that in those countries for example, where interest has been reduced from ten to five per cent. the same quantity of silver can now purchase just half the quantity of goods which it could have purchased before. This supposition will not I believe be found any where agreeable to the truth, but it is the most favorable to the opinion which we are going to examine, and even upon this supposition it is utterly impossible that the lowering of the value of silver could have the smallest tendency to lower the rate of interest. If a hundred pounds are in those countries now of no more value than fifty pounds were then, ten pounds must now be of no more value than five pounds were then. Whatever were the causes which lowered the value of the capital, the same must necessarily have lowered that of the interest, and exactly in the same proportion. The proportion between the value of the capital and that of the interest must have remained the same though the rate had never been altered. By altering the rate, on the

contrary, the proportion between those two values is necessarily altered. If a hundred pounds are worth now no more than fifty were then, five pounds can be worth no more than two pounds ten shillings were then. By reducing the rate of interest, therefore, from ten to five per cent. we give for the use of a capital which is supposed to be equal to one half of its former value, an interest which is equal to one fourth only of the value of the former interest." The fact is simply this, that the interest comprehends two elements, one part of the profits paid for the use of the money, the other as insurance for the risk of loss. Now, no diminution in the value of money with respect to commodities, can make the slightest difference in respect to these two elements. Whatever the quantity of goods be, more or less, that £100 will purchase, the part of the profits paid for the use of the money will still be the proportion of the £100. Nor can any alteration in the value of money have the slightest effect in influencing the risk of the transaction. Whether the usual price of goods be £100 or £50, it can make no difference in the proportion of the profits agreed to be paid for the use of £100, nor in the risk, consequently it can have no influence whatever on the rate of interest. The evident proof of this is, that in America, where of course money has diminished in value with respect to commodities just as in the rest of the world, 10 per cent. is quite a common rate of discount for the best mercantile paper.

65. As, however, it is unquestionably certain that a diminution in the value of money, both with respect to debts and commodities, is caused by an increase of capital or money, it becomes a very important and a rather subtle question, to determine under what circumstances either or both of these results is produced. And it is a question of peculiar interest at the present time, when the abundance of the Australian and Californian gold fields would lead many persons to expect a similar alteration of value as took place at the discovery of America.

66. We do not speak of Australia and California themselves, where gold was a positive drug for some time, but of the effects which may be anticipated in the old established countries of Europe. It is evident that as an increase in the quantity of money is capable of acting on its value, both with regard to debts and commodities, its first effects will be manifested in respect of that on which it first acts. Now, under the artificial system of the currency produced by modern banking, the supplies of gold invariably find their way into banks in the first instance. And the business of banking, as we shall show hereafter, consists in buying debts in a peculiar way, the discussion of which we need not anticipate here. Now, the banks having an unusual quantity of money lodged with them, are of course eager to employ it profitably, and in order to do this they lower the rate of discount, *i. e.*, they give a higher price for debts. Now, though a bill of exchange in its proper sense always represents a past operation, yet they are brought for sale to bankers, chiefly for the sake of funds to employ in a future operation. Now, leaving out of the question any part of the rate of discount which may be due to the risk, a high rate of discount is a proof and a sign of the activity of enterprise. And whenever the high rate of discount arises from the activity of enterprise, it may be laid down as a certainty that there is abundance of enterprise ready to start into existence, and which is only curbed by the high rate of discount. As soon as the rate of discount is lowered, this enterprise is called into existence, and new operations of all kinds are commenced; and as the increase of operations just corresponds to the increase of capital, no diminution in the value of money, with respect to commodities, takes place, though it does with respect to debts. An example of the truth of what we say occurred in the year 1844, when from various circumstances an unusual quantity of capital was accumulated in the hands of bankers, and the rate of discount fell to two per cent., but

no increase in the prices of goods generally took place; that is, there was a great diminution in the value of money with respect to debts, but no diminution in its value with respect to commodities.

67. But however enterprising the country may be, there is a limit to its enterprise, and as soon as that limit is reached, an increased quantity of money can lead to no fresh enterprise; the consequence of which is very manifest. The quantity of money being continually added generates no fresh enterprise, is forced into the previously existing channel of circulation, as it is called, and having no fresh work to do, it merely requires a greater quantity of money to do the same work that a less quantity did before. That is to say, a diminution in the value of money with respect to commodities takes place. One hundred pounds perhaps will now only do the same work that fifty pounds did before, a permanent alteration takes place in the exchangeable relations of bullion and commodities, *and the rate of interest will spring back to its former level.* Because, as we have already observed, the interest is always a definite portion of the profits. And the ratio of £5 to £100 must always be the same, whatever quantity of goods that £100 will purchase, be it much or little. We, therefore, obtain this fundamental law of the effect of the increase of the quantity of money: *That as long as the increase of the quantity of capital affects the value of money with respect to debts, it has no effect on its value with respect to commodities, and as soon as it begins to affect its value with respect to commodities, it ceases to affect its value with respect to debts.* We have illustrated the first part of this proposition by a reference to the case of England in 1844, as a proof of the truth of the latter part of it, we may take the cases of California and Australia, where the exchangeable relation of bullion and commodities were so very different from England, yet the rate of interest is very much higher.

68. Now, the effect in former times was exactly the

opposite to what it is now. When the treasures of the Indies were poured into Europe, there were scarcely any such things as banks at all, or credit. The consequence was that the increased quantity of bullion affected its value with respect to commodities, and had very little influence on its value with respect to debts. Nevertheless, it is certain that the increase of money did give a very great stimulus to industry, even in that age; for the best authorities agree that its diminution in value, with respect to commodities, was only one-half of what it might have been expected from the increase of its quantity.

69. The preceding considerations shew that two classes of persons are equally in fault, first, those who clamor for an unlimited increase of money, thinking that to be the panacea of all evils; and secondly, those who assert that an increase in the quantity of money can do no good, and will only lead to a diminution in the value of money. It depends entirely upon the circumstances under which an increase takes place, whether it is beneficial or the contrary.

70. One thing, however, is positively certain, that whenever money undergoes a diminution in value, either with respect to debts or commodities, in any country compared to its neighbours, it immediately causes an exportation of bullion from that country, and an importation of debts and commodities into it. That is, if the prices of debts and commodities are very high in one country, neighbouring countries will immediately send their debts and commodities there for sale. And the people of that country will naturally send their money to foreign countries to buy debts and commodities where they may be had cheaper than at home. Hence, it is a positive certainty that whenever the rate of discount in two countries differs by a sufficient quantity to pay the expenses of transport, it will immediately cause a flow of bullion from where the discount is low, or the value of money low, to where the discount is high, or the value of money high. A principle of great importance which has been very imperfectly understood, and the neglect of which has

brought on some of the most severe monetary difficulties of this country.

71. We have said that at any particular period, the difference in the rates of interest or discount for the same class of securities, indicates a difference in the risk of the particular security. This does not, however, hold good with the rates of interest at different periods, because a high rate of interest may be caused by the activity of commerce, as well as by the risk of security. Thus, in America the discount on the best bills is habitually 8 or 10 per cent, and this arises from the activity of commerce. On the other hand, a very low rate of interest by no means always arises from the safety of the security, or the abundance of capital, but from the want of enterprise, the stagnation of commerce. Thus, in 1812, when the French Empire was verging upon destruction, J. B. Say says,* "France, from an opposite cause, (*i.e.*, to the activity of enterprise,) saw contrary effects produced. A long and destructive war, which closed nearly all communication with foreign countries, enormous taxes, injurious privileges, the operations of commerce undertaken by the government itself, custom duties arbitrarily charged, confiscation, destruction of property, annoyances, and in general a rapacious system of administration, hostile towards the people, had made all commercial enterprise scanty, dangerous, and ruinous. Although the mass of capital, probably continually decreased, the useful employments to which it could be applied had become so scarce and dangerous, that interest never fell so low in France as at this period, and that which is usually the sign of great prosperity, became at this time the effect of a great distress."

72. This is just one of those cases which make many people think that Political Economy cannot be reduced to a science, and is enough to distract an ordinary reader—that the same visible effect or phenomenon is produced

* *Traité d'Economie Politique*, p. 390. Edit. Guillaumin.

by a totally opposite and contrary cause. But the fact is, that it is all an example of our general law of supply and demand. Now, some causes act upon the supply, and some on the demand. But as supply and demand act in opposite directions, it is manifestly necessary that we must have opposite causes acting upon each of them, to produce the same phenomena. And the real difficulty of the case is to determine whether the change of the phenomena is due to a change in the supply or in the demand.

73. The general neglect to observe that profits ought always to be reduced to the same standard as interest, viz., should be reduced to their rate per annum, leads to some erroneous ideas on the subject of interest. Thus, when profits are said to be reduced to 10 per cent., it seems somewhat paradoxical to say that interest can be paid at 15 per cent. It is nevertheless true, and constantly happens; the apparent paradox only arises from the difference of estimating profits and interest in common language. When persons in trade pay interest it is always calculated by the rate per annum, but it is too common to measure profits by the actual transaction, without reference to the time; thus, if a tradesman pays interest at the rate of 15 per cent. per annum, he makes profits, perhaps, at the rate of 10 per cent. per week, perhaps per day, which is the *rate* of 520 or 3130 per cent. per annum, allowing for the number of working days in the year. Which dissipates the apparent paradox. This at once explains how trade can be carried on at rates of interest, which would seem inexplicable. In ordinary times in London, the second class bill-brokers charge their customers 1s. in the pound for three months' bills, which is in reality interest at the rate of 25 per cent. per annum. In ancient times, and in the middle ages, we know that the rate of interest was very much higher than that. An extraordinary instance is quoted by J. B. Say, from Turgot, of the mode in which the petty provision merchants of Paris carried on their trade in his time. In those days

penalties of the most terrible severity were enacted against the infringers of the usury laws. To shew their absurdity, Turgot instances the advances which money lenders at Paris made to the petty dealers, who buy victuals in the market, to retail them in the different parts of the capital. The charge is two sous a week for the loan of a crown of three francs, which is equal to interest at the rate of 173 per cent. per annum. And it was by means of these loans that the whole of the small provision trade of Paris was carried on. "Nevertheless,"* says Turgot on this point, "the borrowers do not complain of the terms of this loan, without which they could not carry on the trade by which they live. And the lenders do not get very rich, because the exorbitant interest is only the compensation for the risk their capital runs. In fact, the insolvency of a single borrower sweeps away all the profit which the lender can make out of thirty of them."

74. The idea that trade could flourish upon money borrowed at the rate of 173 per cent. seems somewhat startling until we analyse the operation. No doubt the borrower paid two sous a week for a crown, but then, the probability is, that what he paid a crown or three francs for, he sold for three francs and a half the same afternoon. Now, if he repeated this operation once every day, it is clear he would gain at the end of the year 3130 sous. That is, with a capital at no one time exceeding 60 sous, he would gain 3130 sous of profit in the year, which would be at the rate of 5216 per cent. per annum, and out of this he would only pay 173 sous for the loan of the money. So that the apparent paradox vanishes.

75. M. Gustave de Puynode,† quoting from the speech of a member of the last legislative assembly of France, M. Aubry de Vosges, gives an instance which is even

* Cours d'Economie Politique, Vol. II., p. 91. Edit. Guillaumin.

Turgot; Memoire sur les Prêts d'Argent; Œuvres. Vol. I., p. 116.

† Sitting of the 27 June, 1850. De la Monnaie, du Credit, et de l'Impot. Vol. I., p. 80.

more startling than the last. He said, "Every morning the small provision dealers received a five-franc piece to buy the objects, which they resold with a profit of three or four francs. In the evening they repay the five-franc piece, and give 25 centimes in addition. They make no complaint of interest, which is yet at the rate of 1800 per cent." Nor had they any reason to do so, for by borrowing this five-franc piece they made three francs of profit, out of which they only paid $\frac{1}{2}$ franc for interest. If, therefore, the rate of interest was 1800 per cent. per annum, the rate of profit, assuming the gain to be 3 francs per diem, was at the rate of 21,600 per cent. per annum. And the interest, which is only one twelfth part of the profit, is not unreasonable. And yet, by the law of France it is a crime to take more than 6 per cent!

CHAPTER III.

THE THEORY OF CREDIT.

"Hold fast the form of sound words."

II. TIMOTHY. I. 13.

THE THEORY OF CREDIT.

PRELIMINARY REMARKS.

In the preceding Chapters, we have discussed the Theory of Prices, so far as regards commodities and money. We have now to discuss the Theory of Prices, so far as regards Debts. The trafficking in debts of different descriptions is termed the SYSTEM OF CREDIT. The invention of credit is the great distinguishing feature of modern commerce. The system of credit performs exactly the same functions in commerce as the steam-engine does in mechanics. The subject is somewhat intricate, and to appreciate it properly requires a thorough knowledge of its details. It is also the subject on which, from a want of a mastery over details, modern Political Economy is utterly at fault. The first requisite to arrive at an intelligent judgment on the subject, is to have a description of the actual reality. A misconception of the real nature of credit, and an abuse of the system, has led to some of the most terrible catastrophes of modern times. There are two grand divisions of credit, Mercantile Credit, and Banking Credit, which are so thoroughly interwoven with each other in this country, that it is not easy to separate them, and doing so may perhaps involve some

repetition. Nevertheless, as we think it will conduce to clearness, we shall do so. The subject of Credit is one on which it is impossible not to notice the established opinions. We shall, however, endeavour, as much as possible, to keep controversy separated from the detail of facts. We shall, therefore, examine the doctrines of modern Political Economists in a separate section. We shall, therefore, divide this Chapter into three sections.

- I. Treating of Mercantile Credit.
- II. The Theory of Banking.
- III. An examination of the opinions of certain Political Economists on the subject of Credit.

The reader being in the first two Sections put in possession of the actual details of business, will then be in a position to judge for himself, as to who is correct or not.

THEORY OF CREDIT.

SECTION I.

ON MERCANTILE CREDIT.

1. The operations of buying and selling which we considered in the first two chapters, represented a contract which did not involve any ideas of *time* in it, but only of value, and the currency which we supposed to pass between the parties represented a debt, which took effect immediately and simultaneously with the transaction it arose from. It often happened, however, that transactions of great benefit to society could not be performed from the scarcity of the currency, which could not always be procured in sufficient quantities by those who were willing to undertake these operations, and yet when they were done they would repay the original outlay upon them, together with a large revenue or profit. Advancing refinement then perceived the advantage that might be gained by contriving a currency which should be evidence of a debt, but which should not be demand-

able at the time the transaction took place, but at some fixed period after it had occurred, when it might be completed, and produce a revenue to discharge the debt, when it should be agreed to be paid. This is called the system of **MERCANTILE CREDIT**.

2. Such a system as this could only obtain among persons who had confidence in each other's honesty, good faith, and ability to fulfil their contracts, when they became payable. No man would render a service to another man, and promise not to demand any equivalent in return for three months or longer, unless he was well assured that the person who received the service would be able and willing to repay it at the time promised, or that, if he failed to do so, the law would speedily give him redress. It is evident that the basis of such a system is *confidence*, and it is impossible for it to prevail in any place where the people are not known for their general honesty and integrity.

3. The operation may be described as follows. A manufacturer, A, knowing the trustworthy character of his neighbour B, a retail dealer, sells him goods, and instead of requiring immediate payment for them, which may be inconvenient to B, he takes such an obligation from him as was described in Chap. I., Sect. 8, only that he will not require payment until a certain time has elapsed, during which B may reasonably expect to sell them, and receive the money for them from his customers. He must, however, have the evidence of the debt, and the time when it is to be paid. This obligation may be expressed in two ways. 1st. It may be an order addressed by A to B requiring him to pay a certain sum of money at a certain time from the date specified in the order, to A, or to any person he may order. In this form it is called a **BILL OF EXCHANGE**. 2ndly. It may be expressed as a promise emanating directly from B, in the form of a promise by B to A, to pay him or any person he may order, a certain sum of money at a fixed date. In this form it is called a **PROMISSORY NOTE**.

4. A Bill of Exchange is usually in the following form.

£120 10s. 4d.

London, May 4th, 1857.

Three months after date pay to me (or A B) or order, the sum of One hundred and twenty pounds ten shillings and four pence, for value received.

*To Mr. Timothy Gibbons,
Linendraper,*

John Stiles.

Cheapside, London.

John Stiles is called the *drawer*, and Timothy Gibbons the *drawee*. The Drawer then presents the Bill to the Drawee to obtain his promise to pay the money at the date specified; and if he promises to do so he is said to *accept* the Bill, and he is then called the *acceptor*.

5. Formerly any assent that the Drawee gave to the Bill was a sufficient acceptance, and might either be by parol, or verbally, or by any collateral writing, but since 1821, the law, (1 & 2 Geo. iv., c. 78) enacts that "no acceptance of any inland Bill of Exchange shall be sufficient to charge any person, unless such acceptance be in writing on such Bill, or if there be more than one part of such Bill, on one of the said parts." The acceptance is usually signified by writing the words "Accepted, Timothy Gibbons," across the face of the Bill. This act only applies to inland Bills, so that the acceptance of foreign Bills need not be in writing on the Bill, but any collateral expression of intention to pay the Bill when it is due, as by letter referring to it, or verbally, is sufficient. If the drawer wishes to transfer his debt to a third party, he may insert the name of that person in the Bill instead of his own, and that person is then called the payee.

6. A promissory note is usually expressed thus.

£143 4s. 9d.

London, May 4th, 1857.

Three months after date I promise to pay John Stiles, or order, the sum of One hundred and forty three pounds four shillings and ninepence, for value received.

Timothy Gibbons.

In this case Timothy Gibbons is called the *maker* of the note, and John Stiles the *payee*.

7. The above form of words, though most generally used, are by no means essential for their respective purposes. Any form of words addressed by one person to another, requiring him to pay a given sum of money on a certain day, to any certain person, is a Bill of Exchange; and any form of words addressed by one person to another conveying a distinct promise to pay a sum of money on a certain day is a Promissory Note. Many instruments have been worded so obscurely as to render it a matter of great difficulty to decide whether they are Bills of Exchange or Promissory Notes, and in such a case the holder, or legal owner of the obligation, may treat it as either one or the other; nor is it necessary to have the words "for value received" on either, though they are generally inserted. And it is also to be particularly observed, that these obligations must not be directions or promises to be paid by any specific sovereigns, or out of any specific funds, as for instance out of another sum of money payable by some one else, but they must be a general charge of debt on the person of the obligor, payable at all events. An instrument of credit made payable out of a specific fund, or being the title to any specific bag of sovereigns, is not a Bill of Exchange or a Promissory Note, and it is not recognized as such either by law or mercantile custom. Thus, affording a most marked and important distinction between Bills of Exchange and Bills of Lading, which is too often overlooked by uninformed writers, and most erroneous views are propagated founded upon this grievous error.

8. This obligation, therefore, is evidence of A having rendered B a service, but stipulates that B is not to be called upon to repay the service until the time mentioned on the face of the obligation has expired, and in this respect differs from the obligation described in Chap. I. If B is a person in good repute, and is

known to be possessed of means so as to be able to pay the money when the Bill arrives at maturity, such an obligation is capable of passing from hand to hand, exactly in the same way as the one previously described. And it must also be carefully borne in mind, that B is not considered to be actually in debt, until the day for payment arrives, so that this obligation is no diminution of his actual property. It is not intended that it should be paid out of any money in his actual possession, but out of the proceeds of what he expects to gain by his skill and industry in disposing of the goods he has bought.

9. The two forms of expressing this debt are manifestly identical in their effect, nevertheless, mercantile usage invariably adheres to the former form, that of a Bill of Exchange, and in this work where we merely discuss the general effects of the system, and do not enter into a minute account of the petty differences between Bills and Notes, we shall consider the case of Bills of Exchange exclusively.

10. Now, A may be a manufacturer, and require cash to pay his workmen's wages every week, and such a Bill is unsuitable for that purpose, so he endeavours to find some one who will buy the debt from him for ready money. There are persons, such as Bankers, whose special business it is to buy such debts. If the banker is satisfied of the integrity and capacity of the acceptor to fulfill his obligation when it becomes payable, he will buy the Bill from A. Before doing so, however, he requires A to write his name on the back of the Bill, the effect of which is that if B does not fulfill his obligation when it becomes payable, A undertakes to do so for him. In this case A is said to *indorse* the Bill, and the bank, or person, to whom he indorses it, is called the *Indorsee*. The effect of the whole transaction is, that the Banker buys the Bill from A with a warranty of payment from the indorser. He then becomes the owner of the Bill, or more technically,

is said to be the *Holder* of the Bill, and when it becomes payable, demands payment of it on his own account, and not on account of, or as agent for A, to whom the original debt was due; and if the acceptor makes default in payment, the holder may sue him in his own name. In purchasing the Bill the banker calculates the interest, at the rate agreed upon, and retains it from the amount of the Bill, and only advances the difference. This method we have already described as being called *Discount*, so the banker is usually said to *discount* the Bill.

11. It is most carefully to be observed that in this transaction that the banker or other person does not make a *loan* of money to the manufacturer. If he did that, it would be the duty of the manufacturer to restore the money when the bill became due. The real nature of the transaction is that it is a SALE OF THE DEBT. It is the duty of the acceptor to pay the money to the banker, or other holder of the bill; and the manufacturer's name on it is merely a warranty of soundness, as it were, of the debt; and it is only in the event of the acceptor not paying it, that the manufacturer is called upon to repay the money. If the banker did not think that the debt was a good one, he would not buy it, and when the manufacturer has sold it he never expects to hear of it again. It is just like a man buying a horse with a warranty of soundness; if the horse is sound, well and good, the transaction is finished, but if the buyer finds out a blemish within the agreed-upon time, he returns the horse and gets back his money. It is exactly the same in buying a debt. The debt is an article of commerce just like the horse, and the liability of the indorser to repay the money if the debt turns out bad, only lasts for twenty-four hours after the debt is shewn to be bad. If the holder of the bill neglect to demand payment within that time from the indorser, his remedy is gone, and the indorser is discharged exactly as in the case of an ordinary warranty. It is commonly said that the banker *lends* the money to the manufacturer on the security of

the bills. It would be just as rational to say that the buyer of the horse lends money to the seller of it on the security of the horse. The fact is that the banker buys the debt with the security of the manufacturer, just as the other buys the horse, taking a warranty as his security that he shall be repaid his money if the horse is unsound. It is of the utmost importance to obtain a true conception of the nature of the transaction, and from the want of this, the subject, as usually treated, has been thrown into the utmost confusion.

12. The drawer of a bill of exchange usually makes it payable to himself or his order. If it is only payable to himself, the instrument cannot be passed from hand to hand, because, by the common law of England, debts are not assignable. If the bill is payable to the *order* of the drawer, it is only necessary that he should write his own name on the back of it, and then it becomes transferable from hand to hand just like money, without anything further it becomes payable to bearer. Such an indorsement is called an *indorsement in blank*. Sometimes the drawer only indorses it in favor of a particular individual, and then it is called a *special indorsement*. But this holder of the bill may, if he pleases, endorse it in blank, and then it becomes exactly like a bank note, transferable by mere delivery. Instruments which may be transferred from hand to hand by indorsement, or mere delivery, are termed *negotiable instruments*, and to sell them is frequently termed to *negotiate* them. It may also be as well to observe that the word *indorsement* legally means, not merely writing the name on the back of the bill, but *writing and delivery*; without delivery no property passes.

13. The holder of this bill, or the owner of this debt, can treat it precisely as he would any other article of commerce. If he chooses he can keep it himself and reap the profit which accrues when it becomes due. If he is himself in business, and wants to make a purchase, he can either buy commodities with this bill, thereby selling the

debt again, or if he is in want of cash he can sell the bill for money to anyone else, and he will at all events have the profits due to the number of days he has held it. If the person who buys the bill takes it without requiring him to indorse it, or write his name on the back of it, the transaction is finally closed, it is payment, just the same as if it were so many sovereigns. If it is not paid, the holder of it has no recourse against him. But as the holder of it will in general not forego the additional security of his name on the back of it, it is almost invariably usual for each holder in succession to write his name on it when he sells it. Consequently, a bill of exchange usually has on the back of it, the name of every person through whose hands it has passed, except the last.

14. To show how the system of discounting bills accelerates the motion of commerce, we may take a few examples. Goods or commodities pass through the following hands: First, the foreign importer or manufacturer; second, the wholesale dealer; third, the retail dealer; fourth, the consumer. To the first three of these parties the goods are *capital*, because they produce, import, or buy them for the purpose of selling them again, and making a profit from their sale. The fourth buys them for the sake of consumption. It is evident that the consumer, or customer, is the final cause of the goods being produced, and the price he pays for them must be sufficient to reimburse all the original expenses of production, together with the profits of the three preceding operations. It may, however, be a considerable time before the goods pass from the manufacturer to their final destination, the consumer, and the capital employed in their production and distribution replaced, so as to be the cause of producing other operations. Now, it is quite evident that unless the first three classes have further capital to go on with until the consumer has bought and paid for the goods, their operations must come to a standstill for want of moving power, until they

are reimbursed. If, however, they can obtain capital, by selling the debts due to them, to enable them to go on until the proceeds of the first operation fall in, it is clear that they can go on producing without interruption, and supply a continuous stream of commodities.

15. It is for the general interest of the country that money should not stagnate, but should put in motion all the industry it is capable of doing. Many private persons are in no immediate want of the services that money can command, so that if it remained in their hands it would be dead and unprofitable. Moreover, the actual quantity in the possession of each individual may be comparatively small, but if these sums be collected from a great many individuals in a Bank, like a multitude of runlets trickling into a great reservoir, it will have a large sum at its command, and will be easily able to find profitable employment for it, because persons who want capital to carry on commercial operations, know where to obtain the requisite amount.

16. The functions of a Bank, then, in the commercial body resemble those of the heart in the human body. It attracts to itself capital, the life blood of commerce, from every direction, in the minutest rills, and having accumulated it in a great reservoir, propels it through all the arteries and channels of commerce, vivifying and nourishing it, and spreading vigour and health through the whole commercial body.

17. As the price realized from the consumer must afford a profit to each person who renders a service in the production or distribution of the goods, it might be that, after a long course of successful business, they might each accumulate sufficient capital to be able to continue their operations during the period before the return of the first outlay. This, however, can be but seldom the case; and however great their capital may be, they are always enabled greatly to extend their business by the system of selling their debts, which we have described.

18. The great function of a Bank of Discount is to

supply capital to the different parties by buying the debts due to them, to enable them to carry on this continuous stream of operations, and on the payment of a small sum for the convenience and risk, to anticipate the receipt of the price from the consumer. The manufacturer who sells his goods on credit to the wholesale dealer, wants this temporary advance to carry on his works, until he receives the price for them. He accordingly draws a bill on the wholesale dealer for the amount, and takes it to his banker, who discounts it for him.

19. Thus, the manufacturer produces the goods and sells them on credit to the wholesale dealer; the wholesale dealer buys them on credit from the manufacturer, and sells them on credit to the retail dealer; the retail dealer buys them on credit from the wholesale dealer, and sells them for ready money if he can get it, from casual customers, or usually on credit to his regular customers.

20. These are the fewest number of hands that goods, in the ordinary course of business, will pass through; and it is clear that in their passage from the manufacturer to the customer, they will give rise to at least two bills of exchange—not unfrequently to three. Thus, the manufacturer draws upon the wholesale dealer, who accepts to him. The wholesale dealer, who has already accepted one bill for them to the manufacturer, draws another bill for them on the retail dealer, who accepts to him; and not unfrequently, the retail dealer, who has accepted to the wholesale dealer, draws upon his customer.

21. The manufacturer takes the bill accepted by the wholesale dealer to his banker, who discounts it for him; that is, he buys the debt due by the wholesale dealer, and with the proceeds of the sale, the manufacturer may carry on his productions uninterruptedly. But the wholesale dealer has a banker as well, and he is in want of capital to continue his purchases, so he takes the bill he has drawn upon the retail dealer to his banker, who discounts

it for him, that is, he buys the debt due by the retail dealer. Now, the wholesale dealer is the principal debtor to the manufacturer's banker for the amount of the goods, and he is surety to his own banker in case of the failure of the retail dealer to meet his engagement. If the retail dealer draws bills on his customers for the goods, and can induce his banker to discount them, he will be similarly liable on two different obligations for the same goods, as principal debtor to the wholesale dealer's banker, and in the second instance to his own.

22. The bills we have just described are all regular business bills, they originate from real transactions, and they are what are called real bills, or Value Bills, and they are (except the last) what arise out of the regular and legitimate course of business, and are the great staple of what bankers purchase. It is a very prevalent belief among commercial men that business bills are essentially safe, because they are based upon real transactions, and always represent property, but the foregoing considerations will dispel at once a considerable amount of the security supposed to reside in commercial bills on that account, because we have seen that in the most legitimate course of business there will generally be two bills afloat, originating out of the transfers of any given property, so that in the ordinary way there will be at least twice as many Bills afloat as there is property to which they refer.

23. The fact is, that the too common expression that a Bill of Exchange *represents* property, leads to incalculable confusion, and is one of the numberless instances in Political Economy in which an erroneous expression* has caused a very general misconception of the real nature of the transaction and of credit. A Bill of Exchange does not *represent* property at all. It

* I regret that I am myself amenable to my own censure, in my Theory and Practice of Banking, as having, in some instances, unguardedly used the expression without due limitation of its meaning.

represents nothing but *debt*, not even any specific money. It originates out of a transfer of property, but does not represent it, any more than if the property had been paid for in money, would the money represent the property, but would be its Exchangeable equivalent.

24. Now, it is easy to suppose that the manufacturer, the wholesale dealer, and the retail dealer, may all be customers of the same bank, and if they all have their bills discounted by the bank, it may unknowingly purchase a whole series of debts arising out of the transfers of the same property, and it is scarcely necessary to remark that in any large bank two or more of these parties will often be its customers, and the bank will make advances to two or more persons engaged in the same series of operations.

25. The above operations are only what arise in the ordinary course of business; it may sometimes happen that property may change hands much more frequently, and at every transfer a bill may be created. Hence, where the credits are very long and the transfers numerous, it is easy to imagine any number of bills being created by repeated transfers of the same property. In times of speculation this is particularly the case. Now, all these bills are technically commercial or real bills; but it is evidently a delusion to suppose there is any security whatever in them on that account. We may either consider that only one of them represents (if we may use this expression, having explained its great liability to misconception,) the property, and that the others represent nothing, or that each of them only represents such a fraction of the property as is denoted by the number of bills afloat. This was long ago pointed out by Mr. Thornton,* who says, "In order to justify the supposition that a real bill, as it is called, represents actual property, there ought to be some power in the bill-holder to prevent the property which the bill represents from being turned

* Enquiry into the Nature and Effects of Paper Credit. p. 30.

to other purposes, than that of paying the bill in question. No such power exists; neither the man who holds the real bill, nor the man who discounted it, has any property in the specific goods for which it was given." The above consideration shows that the real security of the bill consists in the general ability of the parties to it to meet their engagements, and not in any specific goods it is supposed to represent, the value of which is vague or illusory, and impossible to be ascertained by any one who holds or discounts it.

26. While the preceding sections shew that any given amount of property may, by repeated transfers, originate a considerable number of *bond fide* bills, it is, on the other hand, very common for a bill to represent the transfers of several times the amount of property expressed on the face of it. This is the case whenever the bill is indorsed and passed away for value, and the bill represents as many additional values expressed on the face of it as there are indorsements. A little reflection will make this so clear, that an explanation of it might almost seem superfluous. Thus, let us suppose a real transaction between A and B. A draws a bill upon B, who accepts it for value. A has dealings with C, and is indebted to C for value, in payment of which he tenders his bill upon B, and indorses it over to C. Thus, the bill, by the time it is in C's hands, represents *two* transactions. C deals with D, and in payment indorses over the same bill to D; it then represents *three* transactions. And so it may be indorsed over from one party to another an unlimited number of times, and will denote as many transfers of property. When C indorsed over the bill to D, he merely assigned over to him the debt which A had previously transferred to him. Now, that might be done either by drawing a fresh bill on B, cancelling the first, or simply indorsing over the bill he received from A. Hence, we see that every indorsement is equivalent to a fresh drawing; but if he draws a fresh bill it will represent nothing but B's debt to him, whereas,

if he indorses over the bill he received it will represent B's debt to A, A's debt to C, and C's debt to D; and, consequently, it will be much more desirable for D to receive a bill which represents the sum of so many previous transactions, and for the payment of which so many parties are bound to the whole extent of their estates. Some time ago, almost the entire circulating medium of Lancashire consisted of bills of exchange, and they sometimes had as many as 150 indorsements upon them before they came to maturity. From this also we see, that no true estimate can be formed of the amount of bills of exchange in circulation by the returns from the Stamp-office, as has sometimes been attempted to be done, as every fresh indorsement is in effect a new bill. So that the useful effect of a bill of exchange is indicated by the number of indorsements upon it, supposing that every transfer is accompanied by an indorsement, which is not always the case.

27. In the series of operations we have been considering, the manufacturer is liable on only one obligation, and not even on that in the first instance, viz., as drawer of the bill on the wholesale dealer, and is only liable to pay on his default; but the wholesale dealer is liable on two obligations, his acceptance to the manufacturer, which he must at all events discharge, and, secondly, as drawer of the bill on the retail dealer, which he must discharge in the event of the latter failing to do so. Similarly, the retail dealer is liable twice over if he draws upon his customer.

28. Now, as the wholesale dealer is always liable for the goods in the first instance, and as he disposes of them probably to a considerable number of retail dealers, and takes their acceptances and discounts them at his bankers, it must often happen, in the course of things, that some of these acceptances will be unpaid by the retail dealers, and he will be called upon to pay them. He must, consequently, to insure his own safety, always keep a sufficient amount of his capital either in funds at his

bankers, or immediately available, to meet these contingencies, as, if he fails to meet even one of them, he is bankrupt in the strict mercantile meaning of the word. And as we have seen, that the very essence of a bill is that it must be paid in cash at a fixed time, as the inexorable day approaches, if he has not cash sufficient, he must sell his goods to get it, even at a sacrifice, to meet his own acceptances if his banker stops discounting for him.

29. Now, as even in the best of times the accidents of trade are numerous, it is the height of imprudence for any man to invest the whole of his available means in business and deal in credit obligations at the same time, because it will infallibly happen that he will be sometimes called upon to discharge obligations on the failure of others, and refund the price of the goods. Any man, therefore, who locks up all his available means in commodities, and does not keep a sufficient amount of cash ready at a moment's notice to meet these unforeseen contingencies, is *overtrading*, and the first mercantile convulsion in which credit is damaged and diminished will almost certainly ruin him.

30. Great and important, therefore, as are the advantages gained by the trader from the system of discounting bills, it must never be forgotten that they are liable to be attended with inconveniences of considerable magnitude; and that whoever sells goods upon credit, and takes a bill for them, and discounts it at his bankers, is always exposed to the risk of having to refund the amount of the bill he sold to his banker, and this added to the loss of the payment of the goods themselves, by the failure of his customer, may subject him to the diminution or loss of his credit. Consequently, unless he keeps a sufficient sum of money in hand, or immediately available, to meet these contingencies, he is *overtrading*, or trading beyond the due bounds of his capital.

31. We devoted considerable pains in the second chapter to shew that the price of articles at any given

time depends entirely upon the ratio of demand and supply at that particular time. If the supply be excessive, nothing can prevent the price from falling to any state of depression, until it becomes absolutely unsaleable. The commodity, therefore, will not pay the cost of its production, and unless those concerned in producing it have independent capital to enable them to hold on until the excessive supply is taken off, and save them from selling when the price is ruinously depressed, or to stand the losses, they will all fail.

32. Almost all men in commerce are under obligations, that is, they accept bills of exchange, which become debts on a particular day, and must be paid. To meet these obligations due by them, they have property of two sorts: first, Debts, or obligations due to them: secondly, Commodities. And to meet their own obligations they must sell one or other of these kinds of property. They must either sell their debts to their bankers, or they must sell their commodities in the market. While credit is high, that is, while bankers buy debts freely, they can retain their commodities from the market, and watch their own opportunity of selling at a favorable moment. But if credit receives a check, and the banker refuses to buy their debts, they must still meet their own obligations, under penalty of ruin. They are consequently obliged to throw their commodities on the market, and sell them at all hazards, the supply of them becomes excessive, and this inevitably depresses the price. Traders who have capital enough of their own to meet their engagements without discounting, are able to keep their commodities back from the market, until the extra supply being exhausted, prices rise again, from the natural operation of the demand. Now, as we shall shew in the next section, bankers always buy the debts of traders by creating debts of their own, which are called their "issues," and when bankers refuse to buy the debts of traders, they are said to "contract their issues." Consequently, a contraction of issues, or discounts, is generally followed by a fall in

prices. And this fall in prices happening coincidently with a contraction of issues, was supposed to be caused directly by the diminished amount of currency compared to commodities, which is erroneous, because it was in reality caused by the alteration in the proportion of supply and demand in the market.

33. We see, then, how utterly impossible it is to ascertain the precise effect of the contraction of the issues of banks upon prices, because the change was determined by the quantity of produce which a refusal to discount compelled the holders of it to throw upon the market and the demand for it, and not by their quantity compared directly with the quantity of goods. If, therefore, the holders of one commodity were possessed of much independent capital, and were not compelled to realize, to meet their engagements, a contraction of issues would not affect them much. On the other hand, if the holders of another commodity were in general men who depended chiefly upon credit, and were compelled to sell at a sacrifice to meet their engagements, a sudden refusal to discount for them would cause an extraordinary quantity of that article to be thrown on the market, and would cause a considerable depression in price, which would be determined by the change in the ratio of supply and demand.

34. It was maintained by Mr. Turner,* that in a mixed currency, consisting partly of the precious metals and partly of paper representing them, that prices were artificial—that is, that commodities only bore the prices they passed for, through the general confidence or credit of the community, and that if every person insisted upon receiving coined bullion for his commodity, that it would be impossible that commodities should sell at the same nominal price; and that when precious metals and paper

* Letter to Sir R. Peel on the Resumption of Cash Payments by the Bank of England, in 1819; by S. Turner, Esq., F.R.S., a Director of the Bank. P. 17.

circulate together, although one may be constantly exchangeable for the other, yet that every article is measured by a standard bearing a higher nominal value than it would be possible to obtain if the precious metals were the real measure. Mr. Turner has left one consideration out of view, which will shew that it does not necessarily follow that if a paper currency had never existed, commodities would bear a less nominal price than they do now; because, by the extension of the circulating medium caused by the introduction of a paper currency, a very much greater amount of operations may be carried on than on a metallic basis. If the confidence in the paper currency is complete, it will support exactly the same amount of operations, and be in all respects equivalent to an equal amount of metallic currency. Hence, when a paper currency is added to a metallic currency, if it generates an amount of operations proportionate to its increase, it will cause no change whatever in prices, because the proportion between currency and operations will remain the same. If, however, this increased amount of circulating medium did *not* generate a proportionate increase of operations, then Mr. Turner's view would be quite accurate, and the nominal prices of commodities would be augmented in the same way as if an increase took place in the precious metals. And this was the chief reason why prices increased so much in the sixteenth century, from the importation of gold and silver from America. The Spaniards were a lethargic and indolent race, and they thought that the mere fact of having more gold and silver in the country, augmented their wealth, without proportionably increasing their industry; whereas, the total effect was that there was more gold and silver plate and ornaments in the country, and prices rose enormously, but that was no increase of wealth. The country was not one whit richer than before, except by the possession of an additional quantity of gold and silver plate, but the precious metals diminished in value. But if the same circumstances happened in a

commercial and industrial nation like England or Holland, the probability is that that increase of the circulating medium would have been employed in developing a thousand useful works, and have given birth to a proportionate increase of industry, which would have caused no increase in prices, but a very great increase of national wealth.

35. But if, under such an extension of commercial operations produced by the confidence reposed in the paper currency, that confidence receives a sudden shock, so that credit is destroyed, and a considerable amount of the paper currency is suddenly extinguished, before there has been time to reduce the operations proportionably, it is quite clear that the metallic basis will have a much greater burden to bear, or have to represent a much greater amount of operations than before, and its value will proportionably rise. There will, consequently, be a much greater and more earnest demand for money than before; and those who require to have it, to support their credit and meet their engagements, will have to pay a very much higher price for its use. Money will rise enormously in value, both in respect to debts and commodities; and just as the general community have been depending on credit, and carrying on operations upon its support, so in proportion as that is extinguished, will the price of the use of money rise, until confidence is restored, and people are willing to return to credit, or have diminished their operations in proportion to the diminished currency.

36. It is this sudden failure of confidence and extinction of credit, which produces what is called in commercial language a "pressure on the money market," and which causes money to be "tight." When money is said to be scarce, it does not mean that there is a smaller quantity of money actually in existence than before, there may be more or there may be less—no one can tell what the amount of money in existence is; but a great amount of credit which served as a substitute, and was an equiva-

lent for money, is extinguished, and the money is called upon suddenly to fill the void. When a new field of commercial adventure is discovered by sagacious discerners, or a new market is suddenly thrown open by a change in the commercial policy of foreign nations, the first adventurers usually reap immense profits; as soon as this becomes generally known, a multitude of other speculators rush into the same field, excited by the profits reaped by the first. Numbers of merchants and traders purchase commodities on credit, that is, they incur obligations which they must discharge at a future day, in the hopes that their returns will come in before the day of payment. But the immense quantity of goods poured in usually gluts the market in a short time, and from the excess of supply prices tumble down, often to nothing, so that the goods become unsaleable, and either no returns at all come in, or such as are quite inadequate to meet the outlay. When this occurs it is called *overtrading*, and when this has been extensively practised, it is necessarily and inevitably followed by a great destruction of credit, and a great demand for *cash*. Thus, credit is destroyed faster than operations can be reduced in proportion. Those traders who have not received the returns they counted upon to meet their engagements, must raise money on any terms, and perhaps sell what property they have at any sacrifice, to save themselves from ruin. The effect of this will be, that money, for which there is an intense demand, will rise greatly in value, and the rate of interest or price of its use will increase; but as a necessary concomitant of such a state of things, a great quantity of goods will be thrown upon the market, and their price will be enormously depressed. These circumstances will, therefore, produce a very high rate of interest, and ruinously low prices, which must continue until the excessive supply of goods is exhausted, and confidence revived. In such crises as these, traders who have not sufficient capital of their own to meet their engagements, and hold on their goods until prices rise, will infallibly be ruined.

Under such circumstances the rate of interest bears no relation whatever to the rate of profit. The use of ready money to persons who have overtraded, is of infinitely more consequence than the price they pay for it; it may be well worth their while to pay 15, or 20, or even 50 per cent. for the use of money for a temporary emergency, which may save them from ruin, and enable them to maintain their position.

37. It is, therefore, not the scarcity of money, but the extinction of confidence, which produces a pressure on the money market; and an examination of all the great commercial crises in this country will shew that they have always been preceded and produced by a destruction of this credit, which has usually been brought about by extravagant overtrading and wild speculation, as we shall have occasion to see hereafter.

38. The principle which we were at considerable pains to establish in the second chapter, that the relation between supply and demand is the sole regulator of value, combined with the action of the credit system we have just been considering, will explain all the phenomena witnessed during a pressure on the money market. The failure of credit in any one branch of business will produce its full effect on the general market-rate of interest, because that is regulated by the ratio of the demand for money from whatever quarter it comes. But it will not necessarily follow that the market prices of all commodities will be depressed. The market price for each commodity will be governed entirely by its own peculiar circumstances. If the holders of one commodity have independent capital, and have prudently abstained from overtrading, the price of such a commodity will not suffer much, because the ratio of supply and demand will not be altered, though it cannot avoid sympathising to a certain extent with other commodities. But if the holders of another species of commodity have overtraded and depended too much on credit, without sufficient means, they will necessarily be obliged to throw a great quantity

of their produce on the market to realize, and this excessive supply will depress the price. And this effect will be increased, because such are the very times when persons who have ready money are particularly cautious in buying, partly because they always hope the market will fall still lower, and they hope to buy cheaper when prices have fallen to a minimum, and they will certainly not buy more of any commodity than they can help which is diminishing in value; and partly because they must keep their ready money by them to maintain their own position. From these causes, not only is the supply increased, but the demand is diminished, so that the fall is doubly aggravated. Thus, we see at once, that a falling market will always be well supplied, because people who must sell hasten to do so before the price falls still lower, and buyers hold aloof, waiting as long as they can, to see the lowest. On the other hand, when markets are rising, the case is reversed. The sellers hold aloof, hoping the price will still be higher; and buyers crowd in, hastening to purchase before the price rises more. When a market is desponding and inactive, the great method of imparting activity to it is to persuade people that things have reached the lowest, and are on the turn. It is evident that these considerations and observations apply to home produce, or at least to produce which is already in this country, and which can be thrown on the market immediately. In order to attract foreign produce the market must rise high for a considerable time, with the appearance of continuing so.

39. Leaving out of the question extravagant credit and overtrading, which are the abuses of credit, it will appear that the effect of a legitimate and proper use of credit is to equalise prices, and to make them more steady than they would be without it. If the manufacturer were to call for immediate payment of the goods from the wholesale dealer, he would have to dispose of them quickly to realise the proceeds, and if the market were

already overstocked, it would only produce a greater fall. On the other hand, if there were a great scarcity, and the price rose high, the manufacturer might not be able to produce quick enough to meet the favorable moment. But when the period of the credit is fixed and defined beforehand, the holder of the article may be more leisurely in his operations, and watch for a favorable opportunity to sell without being compelled to glut the market. It also causes the supply of commodities to be far more abundant, because, if there were no credit, none but persons of actual capital could invest money in purchases which would not bring in any return for some time. But, by the system of credit, persons of small means are enabled to start themselves in business, and by strict integrity and frugality may accumulate solid capital of their own.

40. The part of the general system of credit which we have been considering, consisted in this, that individuals, through trust in their integrity, were able to draw into their possession the property of others. Their "promise to pay" was equally efficacious to effect a sale of goods to them, as if it were real money. In this case it has operated to transfer goods that were already in existence. But it is equally capable of being applied to the creation of commodities, meaning by the word "creation," what Political Economists generally mean by "production" or "formation," in its limited sense, and not the theological confusion of its original meaning, which we are chiefly accustomed to. A trader who buys with his promise to pay, intends that it shall be replaced by the profits arising from the operations it generates. But credit may be equally applied to create a product, with a similar intention of replacing it out of the profits of the operation. It is often seen that an enterprise will be profitable and self-supporting, if the means can be procured for setting it in motion. A loan of real capital will effect this; but in default of real capital, credit may often be used as efficaciously, for a short period, to supply the moving power required to start such

an operation, and, having performed this temporary duty, be extinguished.

41. As an example of such a *creation* of a product, we may take such a case as this:-- Suppose the corporation of a town wishes to build a market-hall, but has not the ready cash to pay for the materials, and builders' and workmen's wages. It may be a matter of perfect certainty, that if the market were once built the stalls in it would be taken up immediately, and the rents received for them would liquidate the debt incurred in erecting it. But as the workmen cannot wait till that period, but require immediate cash to purchase necessities, it is clear that unless there is some method of providing ready payment they cannot be employed. In such a case as this the corporation might either borrow real capital from other parties, or, if they were in good credit, they might issue bonds for various amounts, bearing interest, payable at certain fixed dates. If these were made in sufficiently small sums, and if they were readily received by the dealers in the town, they might be used in the payment of the workmen's wages, and perform all the functions of a currency, and be equivalent to money. They would, therefore, be as efficacious as real capital. These bonds might be redeemable at different periods, and when the market-hall was finished, and the stalls let, the rents for them would gradually redeem, or pay off the debt incurred for building it. It is said that more than one market-place has been built by adopting such a plan as this.

42. This is an instance of the *creation* of a product by credit, and not merely the transfer of an existing product. The result to the corporation would be precisely the same, whether they accomplished their object by borrowing real capital and paying interest for it, or by issuing bonds, bearing interest, payable at fixed periods. In the one case, they would be liable to the full extent of their property to the persons from whom they had borrowed the money; in the other, to those who held their bonds. If

the operation was successful, its profits would in the first case pay the persons who had lent the money; in the second, the profits would pay the persons who held the notes, and extinguish the liability of the corporation. If the operation were unsuccessful, the corporation would equally have to make good the loss out of their general effects, either to the lenders of the money, or to the holders of the notes. It would, therefore, be a matter of no consequence whatever to the corporation which way they adopted to accomplish the work; but it would be a matter of importance to the town at large, because, if they borrowed real capital to do it, that would by so much diminish the fund of moving power applicable to other species of industry, and raise its price. It is clear, therefore, that the second method would be so much clear addition to the capital of the community, and would therefore be most advantageous for them.

43. This second method of utilizing credit, from not being based upon *real* capital, is an instance of what is usually called *fictitious* capital, a name of extreme inaccuracy, which too many persons are in the habit of using, from the hasty assumption that what is not real must necessarily be fictitious, and are more led away by a jingling antithesis of words than an accurate perception of ideas. If the bonds issued by the corporation were not redeemable, and represented nothing, the epithet *fictitious* would be accurate. But such is far from being the case. In both cases it resolves itself into the present value of a deferred payment. In the first instance, the obligation incurred by the corporation to the lenders of the money would not be limited to the specific capital they advanced, but would be a general charge on the whole property of the corporation; the bonds issued in the second case would be precisely the same, they would confer upon the holders of them a general charge upon all the property of the corporation. The security to the holders of the corporation's obligations would be absolutely identical in either case. If the corporation spend the money, it is absolutely gone

away from them for ever, and is no more a security to the holders of their notes than if it had never existed. In either case, then, it is the permanent property of the corporation which is the real security of the holders of its notes; and they have the same general charge over it in both cases. It is, therefore, to the last degree inaccurate and untrue to distinguish one case by the term real capital, and to brand the other as fictitious. There is absolutely no distinction at all between the two cases, as far as regards the corporation and the holders of its obligations, the profits and the losses are identical in their effects in either case. The true difference is to the community at large, and the general fund of capital available for its use, and its only effect is to make capital somewhat cheaper than it would otherwise be; and a judicious and successful employment of it eminently conduces to the national prosperity.

44. The only advantage of the second method is that it makes capital more abundant, and sometimes might provide it when not otherwise obtainable. If it were scarce, or otherwise occupied, it might not always be possible to obtain it. If nobody had money to lend, the second method might supply the want, and so long as it is practised by judicious persons, and used in promoting successful operations, it is a great blessing. But it is just on this very point, that it is liable to the most dangerous abuse. If the corporation were limited to the use of real capital advanced by some independent person, he would probably take into consideration the purpose to which it was to be applied, as well as the solvency of the corporation, and if he thought it injudicious, he would probably not advance it. There would, therefore, be so far a check upon them, but if they were totally destitute of control, and could embark in any operation, by simply writing a few "promises to pay" upon bits of paper, they may be led away into wild and dangerous speculations, deceived by false expectations of profit, and involve themselves

and all who trust them in ruinous losses. Because, though these promises to pay did not represent real advances, and are therefore inaccurately called fictitious capital, if they get into circulation and people give value for them in commodities or services, a disastrous operation based upon them is just as much loss of capital, as if they had been real advances.

45. We have thus shewn that in the production of commodities, which term must be held to include both the formation and the transfer of commodities, credit performs exactly the same functions as money, so far, therefore, as production goes, credit is in all respects equivalent to money. And so long as the operations are successful, everything goes well. Money being, as we have laid down, the representative of the fruits of a man's past industry, and credit a pledge of his future industry. It is certain that "credit" exceeds "money" many times in this country, for whereas it is not supposed that the actual money exceeds £60,000,000 the credit in Bills of Exchange, and which is only one form of it, exceeds £400,000,000. That is, the people of this country have always pledged their future industry to the extent of four hundred millions. And this £400,000,000 is equally capital, it is equally a real value as the £60,000,000. No doubt it is of a different description, it is more perilous, a portion of it may perish. But it is an undeniable fact that it has performed the same functions, so far as regards production, as money. It is a distinct and separate value over and above commodities, totally different from Bills of Lading, which merely represent particular commodities. Bills of Exchange are not a lien upon property but upon industry, and any property a man possesses is only a kind of collateral security to make good his engagements, in case his industry is unsuccessful.

46. In the case we examined of a bank discounting the bill of the manufacturer A, upon the dealer B, the transaction was already effected upon which it was founded. A had rendered the service to B for which he was

to be paid at a future day, *before* he drew the bill upon him, and originally all bills of exchange represented previously existing debts, and they bore on the face of them the words "for value received" to testify the fact. Consequently when A discounts the bill founded upon that transaction, with the bank, it must be carefully observed that he is not *borrowing* money from the bank, but selling a debt which is his existing property. And so long as Bills of Exchange are restricted to representing past transactions, their negotiation is not borrowing money as is too frequently said. But the sharpness of traders discovered that they might be applied to future transactions.

47. In the case of a *past* transaction, the bill was given by B, who had got the goods, to A who had given them, and A had got the money that would be payable to him at the maturity of the bill, advanced to him by the bank on the credit of B's reputation, as well as his own. If B, however, be a person of wealth and reputation, he may lend the use of his name to A without any real transaction having taken place between them. Thus, he may accept a bill of A's, and A, on the strength of his name, goes to his banker, and gets the money, with which he performs some operation, such as manufacturing goods, and having done so he may sell them to C, and take C's bill in payment of them, which latter is a real transaction. Now, the whole of this operation is based upon the credit of B's name, it is not based upon anything real, or upon any service previously rendered; consequently it is in itself a completely new transaction. Such a bill between A and B is called an ACCOMMODATION BILL. This name is, however, not confined to cases where the acceptor lends his name for the accommodation of the drawer, though that is the most usual form, but wherever an acceptor, drawer, or endorser puts his name upon the bill, and therefore renders himself liable to a holder for value to discharge it, without, as the legal expression is, consideration moving to him, it is an

accommodation bill, and the party for whose accommodation it is negotiated is bound by law to provide funds to discharge it at maturity, and also to indemnify the accommodation acceptor, drawer, or indorser, as the case may be, against the consequences of non-payment.

48. The practical effect of this transaction is simply that B stands security to the bank for the money advanced to A; and there is nothing in the nature of such a transaction worse than for one man to stand security for another in any other commercial transaction. In some respects it is much fairer to the person who runs the risk as security, because in the ordinary course when one person becomes security for another, he does not receive any pecuniary recompense for the risk he runs, to which he was certainly most fairly entitled, whereas if it be done by way of accommodation bill he generally receives some *quid pro quo*, and when a bank performs an operation of exactly the same nature, it always receives a high interest for the risk it runs, and when judiciously done is a very profitable source of income. From the extravagant abuse, however, of such methods of raising capital, accommodation bills have acquired a most discreditable reputation, and there is nothing which requires more vigilance in a bank than to guard against being entrapped into making unwary purchases of such securities.

49. A great deal has been said and written about the difference between real and accommodation bills, and while no terms of admiration are too strong for the first, no terms of vituperation are too severe for the latter. Thus, Mr. Bell* says: "The difference between a genuine commercial bill and an accommodation one is something similar to the difference between a genuine coin and a counterfeit," as if the act of negotiating an accommodation bill were in itself one of moral turpitude. It is also generally assumed that real bills possess some sort of additional security, because it is supposed that there is

* Philosophy of Joint Stock Banking, p. 51.

property to represent them. We have already seen, however, the entire delusion of such an idea, and that it is a great mistake to suppose that commercial bills have any specific relation to the property from the transfer of which they originally sprung. In truth, both real and accommodation bills have precisely the same security, they constitute a general charge upon the whole estates of all the obligants upon them. The objections to accommodation bills, therefore, on that ground are perfectly futile, for the security of both is exactly identical, and as Mr. Thornton long ago remarked:* “The supposition that real bills represent property, and that fictitious bills do not, seems, therefore, to be one by which more than justice is done to one of these species of bills, and something less than justice to the other.”

50. The essential distinction between real and accommodation bills is, that one represents a *past* and the other a *future* transaction. But even this is no ground for any preference of one over the other. A transaction that *has been* done may be just as wild, foolish, and absurd as the one that *has to be* done. The intention of engaging in any mercantile transaction is, that the result of it should repay all the outlay, with profit. There is no other test but this of its propriety, in a mercantile sense. Such things have been heard of in the mercantile world, as consignments of skates to tropical countries. Now, a bill drawn against such a shipment as this would pass muster in technical language as a *real* bill, while one drawn to forward some other operation, however sound and judicious it might be, if it were not yet accomplished, would be an accommodation bill, and be branded as fictitious. Mr. Bell would call the former genuine coin, the latter counterfeit.

51. We see, therefore, that the common objections urged against accommodation bills are perfectly futile, and quite wide of the mark. Whether a bill be a good

* Enquiry into the Nature and Effects of Paper Credit, p. 32.

and safe bill, has no reference to whether it represents a past or future transaction, but whether it is a safe and judicious one itself, and the parties to it respectable and of sufficient means to meet their liabilities. The whole cash credit system of Scotland, which has conduced so eminently to the prosperity of that country, is a system of accommodation paper, which is sufficient to disprove in the mind of any dispassionate person, that the system is in itself necessarily dangerous and pernicious, but is proof enough that if it is judiciously managed it may be of great advantage.

52. The true objection to accommodation paper is of a different nature. When the credit system is carried on duly and properly, and within legitimate limits, it is the most ingenious method ever devised for promoting commerce, and where it has been cautiously used, has marvellously succeeded in so doing. But it is a very trite remark that the best things when corrupted become the worst. This is eminently true of paper credit. Universal experience proves that there is nothing so dangerous and pernicious as for individuals to have an undue facility for obtaining credit. When capital is to be had on too easy terms, it fosters to an extravagant extent the fatal propensity for embarking in all sorts of wild speculations, and pushing trade far beyond the possibility of being remunerative.

53. The considerations we presented shewed the exaggerated ideas of the security of real bills. But there is at least this security in real bills, that as they only arise out of real transfers of property, their number must be limited, in the very nature of things. However bad or worthless they may be individually, they cannot be multiplied beyond a certain extent. There is, therefore, a limit to the calamities they cause. But with accommodation paper there is no limit. A beggar may write upon bits of paper a million of "promises to pay" as easily as a Rothschild; and it is far more probable that he will do so; a man without a farthing is proverbially the

most reckless, because, when the bubble bursts, it is a matter of no consequence to him, he has nothing to lose, the misery and the ruin fall upon his unfortunate dupes. A man of real capital will be cautious in his operations, a loss to him will be real, but a man who is not worth a sixpence, is indifferent whether he loses a £1,000 or a £1,000,000.

54. This system of accommodation paper of different descriptions, is one of immense importance in modern commerce, and its abuse has led to some of the most terrible mercantile catastrophes on record. It is, however, so intimately interwoven with banking, that we shall defer any more mention of it till the next section, which treats of the operations of Banking.

55. We have observed that so far as regards production, which, in a scientific sense, includes the formation and transfer of products, credit, whenever it is applied, performs exactly the same function as money. As in this section we wish to avoid all controversy, and merely to state facts, we will only say that all commercial transactions on credit, are SALES. The absolute property of the article passes from the vendor to the purchaser, just exactly as if the price had been paid in money. The only difference to the purchaser is, that his profits are less, because the credit price is higher than the money price. So long as matters proceed smoothly, and transactions are profitable, the bills generated by commerce are equivalent to so much money. The difference arises when the sales are unprofitable, and losses ensue. If the wholesale dealer buys from the manufacturer for ready money, and the speculation is unfortunate, the whole loss falls upon the dealer, the manufacturer does not lose, he has got his money. But if the speculation is unfortunate, and a loss ensues, or if the wholesale dealer fails from other reasons, the loss may fall upon him. When he has sold on credit to the dealer, his power over the goods is absolutely gone; and if the bill is unpaid he cannot reclaim the goods, even if they are still in the

possession of the purchaser, he has no more claim to them than any other creditor. Consequently, if the dealer has not sufficient funds to pay his debts, the loss falls upon the original manufacturer. In this, then, consists the whole difference between sales on credit, and sales for money, that if losses ensue they may be differently distributed. No doubt the manufacturer finds that a bill of exchange is not so negotiable as a bank note or money, but it is of the same nature, and must be placed in the same category. The money is nothing but a bill on the whole community. Good bills of exchange do to a certain extent circulate in commerce like money; but the manufacturer generally finds it more convenient to sell the bill to his banker, and how the banker buys it will be explained in the next section.

56. Now, we have shewn in the first chapter of this work, that capital, in its most general sense, is not any particular thing, but a particular method of employing a quality, be it currency or anything else, in reproductive operations. In its more original and narrow sense, it is the purchasing power of the merchant, or it is the moving power at his command to generate a circulation of commodities, out of which he reaps his profits; it is the power which draws the goods out of the possession of the manufacturer into the possession of the dealer, for him to make a profit. The money he has is the fruit of the services he has formerly done to the community. Credit is also the power he has of drawing the goods from the possession of the manufacturer, and is the pledge of his skill in rendering future services to the community, by discerning their wants and supplying them. The effect upon the markets and upon prices is exactly the same, whether purchases, *i.e.*, circulation of commodities, be generated by credit or real capital, and the profits and losses are exactly the same to the community, whether the operation be effected by credit, or by real capital. Hence, we arrive at this conclusion, that **MERCANTILE CREDIT IS MERCANTILE CAPITAL.**

57. It has frequently been observed that all great inventions have an equalizing tendency; the invention of gunpowder equalized the condition of the poorest foot soldier and the wealthiest knight, and it destroyed the supremacy of the knights; the invention of printing opened up the paths of knowledge to the poorest as well as to the rich, and destroyed the supremacy of wealth in the acquisition of science; the invention of steam and railroads has equalized the means of locomotion to the humble and the wealthy; so the invention of credit has destroyed the supremacy of capital or money, and has provided the means for the most humble to place his foot on the first step of the ladder of opulence. It is a matter of common observation that nothing is so difficult as the first step to wealth; that many men could get on if they had only a beginning. Now, credit supplies the means of attaining that first step to all. Credit is a mighty power, and no doubt like other great engines, is liable to be abused; but it is entitled to take rank with gunpowder, printing, and steam, among the marvels of human ingenuity, and which has been the chief cause of the magnitude of modern commerce.

THEORY OF CREDIT.

SECTION II.

THEORY OF BANKING.

1. Having in the preceding section said what appeared to us to be necessary to explain the nature of Mercantile Credit, we now come to the other grand division of the subject, namely, Banking Credit. Our present object is not to consider all the points of practical banking, but merely to explain the theory of the subject, and to shew how it acts, and the functions it performs in commerce.

2. The business of a merchant is to deal in commodities, the business of a banker is to deal in currency. A merchant buys and sells commodities, a banker borrows, and buys, and sells, currency - two species of business which are essentially distinct from one another, and which can seldom be undertaken on a large scale by the same person or company, and the attempt to do so has in many cases led to the most disastrous results.

3. The first thing to be done to gain a clear insight into the subject, is to determine the meaning of the word "a bank," and "to bank"; and to understand in what

"banking" consists. It is usual to derive the word *bank* and *banker* from the Italian word *banco*, because the Italian money dealers used to pile their money upon a *bench*. It may probably be that this is the origin of the word *banker*, but paradoxical as it may appear, it seems very doubtful whether the word "to bank," and "a bank," have any etymological connection with *banker*. At all events, however that may be, the words *bank* and *to bank* have acquired a meaning altogether different from that of the business of the persons who employed a *banco*, and this we now shall endeavour to elucidate.

4. We must observe that the word in Italian for a Joint Stock, or common fund, is *Monte*, a heap, a *bank* formed by the contributions of various persons. Thus, public loans were always called *Monti*. It was the commissioners charged with the management of the public loans of Venice, which were called *Monti*, that were formed into the Bank of Venice. And this is precisely the meaning of the word Bank in our earliest English writers. Thus Bacon says,* "Let it be no BANK, or common stock, but every man be master of his own money;" a sentence which is quite unintelligible if bank is derived from *banco*. So also Evelyn speaks† of the "Monte di Pietà at Padua, where there is a continual BANK of money to assist the poor," where it evidently means an accumulation of contributions. So also he says,‡ "The great BANKS are set up for those who play at basset," again evidently meaning a heap. So also describing the scandalous scene at court, on the last Sunday evening of Charles II. he says,§ "A BANK of at least 2,000 in gold." It is perfectly manifest that in all these places the word bank is the equivalent of the Italian word *Monte* and not of *banco*.

5. Be this as it may, however, we must state what

* Essay upon Usury. † Diary, Vol. i. p. 211. Edit. 1850.

‡ Ibid. p. 216. § Ibid. Vol. ii. p. 210.

the functions of the first banks were. The cause of the institution of the Bank of Venice and its uses were these. Venice was a small state, but gradually became the centre of an enormous foreign commerce, and as a natural consequence, an immense quantity of coin of all sorts of different countries and denominations were brought by the foreigners who resorted to it. These coins were moreover greatly clipped, worn, and diminished. This degraded state of the current coin, produced intolerable inconvenience, disorder, and confusion, among merchants, who when they had to make or receive payment of their bills, had to offer or receive a bagful of all sorts of different coins. The settlement of every bill, therefore, involved perpetual disputes—which coins were to be received, and which not, and how much each was to count for. In order to remedy this, it became absolutely necessary that some fixed uniform standard of payment should be devised to ensure regularity, and a just discharge of debts. In order to do this, the Chamber of Loans, or the Commissioners who had the management of the public debt, undertook the functions of a bank of deposit. Every merchant deposited with the bank all his coins of different weights and nations. These were all weighed, and the bank gave him notes, exactly corresponding to the real amount of the bullion deposited. And these notes promised to pay the bearer on demand, a definite quantity of bullion of the proper fineness. These notes, therefore, always insured a uniform standard of payment, and it was enacted that all bills upon Venice should be payable in the bank money. The consequence was evident. As the bank money always retained its proper weight, it was much more valuable than the degraded coins in circulation. The difference was usually 9 per cent., though sometimes much more. This difference was expressed by saying that the bank money bore an *agio*, or premium, of 9 per cent., a mode of speaking very likely to confuse and mislead, because it is quite evident that it was the bank money which was

the true standard, and the current coin which was at a discount.

6. Moreover, the bank professed to keep all these coins in its vaults. It made no use of them in the way of business; and consequently the notes in circulation were always exactly equal to the amount of the coin they displaced. This bank never did any business on its own account, by way of discounting bills.

7. The Bank of Hamburg was established for the very same reason, and for the very same purpose as that of Venice, viz., for the purpose of insuring a uniform standard of payment of mercantile bills. It was there enacted that all bills upon Hamburg for 300 guilders and upwards, should be paid in Bank money. John Law says,* that the Bank of Sweden was instituted for very much the same purpose. The money of Sweden was at that time made of copper, and very inconvenient to make payments in. It was necessary to have a cart to carry a moderate amount of it. To remedy this a public bank of deposit was established, where the merchants deposited their copper money, for which they received promissory notes payable to bearer, on demand, in which payments were made. Law says that this was the earliest institution of the kind, and that the use of them in Italy was subsequent to the bank of Sweden.

8. All these banks were in exact conformity with the sense which we believe to be the genuine one of the word Bank. They were a common fund formed by the contributions of various individuals, and they all issued promissory notes payable to bearer on demand, which however, did not exceed in quantity the bullion they were substituted for.

9. All this time, the names of banks and bankers were utterly unknown in England. The name of banker was first introduced in England in the period of the Commonwealth. Up to the year 1640, the merchants used

* *Memoires sur les Banques. Œuvres. p. 524. Edit. Guillaumin.*

to deposit their cash and bullion in the Mint in the Tower for the sake of security. But in that year, Charles I. suddenly seized it, and after that the merchants were obliged to keep their bullion at home, under the care of their own clerks and apprentices. These clerks, however, in many instances robbed their masters, and joined the army. Others lent out their masters' money clandestinely to the goldsmiths, at the rate of 4d. per cent. per diem. The goldsmiths then began to receive deposits at interest, and they gave their customers their deposits at any moment they required them. These goldsmiths then began to trade with these deposits, and to discount the bills of merchants. The convenience of persons being able to deposit their money where they could have it, along with the interest, at any moment they pleased, instead of having to invest in real or personal security, was so great that deposits rapidly flowed in upon them, and they then came to be called Bankers, but their houses or establishments were never called Banks.*

10. In return for the deposits lodged with them the goldsmiths granted receipts, which were transferable from hand to hand, and payable to bearer on demand, like the notes of the different banks we have been considering. They were transferred by indorsement. But more than that, when they discounted bills they did it by giving their own promissory notes payable to bearer on demand for them. No doubt, when they first began this practice, people were not much accustomed to them, and would frequently demand the money for them. But in process of time, as confidence increased, demand for payment would diminish, and they would pass equally freely with money. In process of time, then, the goldsmiths would discover that the actual quantity of money demanded in payment for their notes would bear a pretty steady ratio to the number of them out,

* For a fuller account of the rise of Banking in England, see my *Theory and Practice of Banking*. Chap. VIII.

and by carefully observing this proportion, and always keeping an abundant surplus in case of any unusual demand, they would learn how many bills they might safely buy with their "promises to pay." These notes were called goldsmiths' notes, and afterwards bankers' notes.

11. Now, we must observe that while the notes of the banks we have described were exactly limited to the quantity of bullion they represented, the notes of the goldsmiths far exceeded the quantity of bullion deposited with them. But they charged exactly the same price for their use, as if they had been actually money, and while they circulated they were in all respects equivalent to money. Consequently the amount of these notes in circulation over and above the quantity of bullion in the coffers of the goldsmiths, which they were obliged to keep to sustain the credit of the notes, was exactly equivalent to so much additional money, both as regarded the goldsmith and as regarded the public. Each of them reaped as much profit from these notes, as if they had been actual guineas. Now, these notes were credit, and consequently we see in this instance that credit was capital.

12. Some-time after this, in 1695, the Bank of Scotland was founded with a capital of £100,000, of which a tenth was paid up. This bank did not receive any deposits from the public, but it was allowed to issue notes *ad libitum*. For several years it issued no notes below £5. Within ten years after it was founded, its notes in circulation were equal to five times the amount of bullion in its coffers, and these notes were in all respects equivalent to so much additional money to the nation.

13. The Bank of England was the first monetary institution in England to which the name of bank was applied. It was formed of a number of persons, who subscribed £1,200,000 to carry on the war with France. They were formed into a corporation, and they were allowed to receive deposits from the public. Moreover,

they were allowed to issue promissory notes, payable to bearer on demand, to the amount of £1,200,000, the sum they lent to the government, and they received £100,000 a year as interest for the money they lent to government. The corporation was allowed to deal in bills of exchange, buy or sell bullion, lend money on the security of goods, wares, and merchandize; but not to meddle with any other description of trade.

14. Now, we observe this—that the original capital of the bank (£1,200,000) was lent to the government to promote the war, and the company was allowed to create an equal amount of notes to trade with; the credit of which was supported by the annuity they received from government. The consequence of this manifestly is, that these notes were over and above the previously existing money in circulation, and were exactly equivalent to the creation of so much money. And such was the effect of the additional capital created by the credit of the goldsmiths and of the bank, that the rate of interest, which was previously 8 or 10 per cent., even in time of peace, was reduced after five years of war to 3 per cent. The bank not only got the benefit of the interest on the original sum advanced to government, but they were able to reap the mercantile profit on the equal sum in notes, which they were allowed to trade with.

15. Some subsequent enlargements of the capital of the bank were made by fresh loans to government, and on each occasion the bank was allowed to create additional notes to the extent of their advances to government. Hence, it is perfectly clear that on each of these occasions a creation of so much additional money took place, over and above the previously existing amount in circulation. At length all limitations to its issues were removed; and it was allowed to issue any number of notes it pleased, upon the indispensable condition that they should be payable to bearer on demand. And no limitation was again imposed upon them till the Bank Act of 1844.

16. The essential feature of a “bank,” then, at this

period was to issue promissory notes payable to bearer on demand, which were to circulate as money. That is, to create currency. And the meaning of the word "to bank," was to receive money and give notes payable to bearer on demand, in exchange for it, and to buy bills of exchange with their promissory notes. Thus, John Law says,* "*La banque est un credit general.*" And that this is the true meaning, there is abundant proof.

17. When the Bank of England was established, it received no monopoly in its favor, and very soon afterwards parliament endeavoured to erect another bank, called a Land Bank. The failure of the attempt to do this seriously embarrassed the government, as the capital of this second bank was to be advanced to government, like that of the Bank of England, to assist the war. The project, however, fortunately for the country, totally failed, and the Bank of England having come forward to assist the state in this emergency, were able to prevail upon parliament, to confer upon them a monopoly so far as this, that no future bank should be erected or countenanced by parliament during the continuance of the charter. This, however, did not by any means prevent any private banking company being established, with any number of partners. Nor was there anything contrary to common law that it should be a joint stock company, that is, with transferable shares. A few years before the Bank of England was founded, the first joint stock companies mania occurred in England. And there was no reason why a joint stock bank should not be formed as well as any other company. But it would seem that a bank was considered so essentially an affair of state, that no one for a long time thought of such a thing as establishing a private joint stock bank.

18. At length in 1708, a company called the Mine Adventurers of England, commenced banking business by issuing promissory notes payable to bearer on demand,

* Second Memoire sur les Banques. Œuvres, p. 543. Edit. Guillaumin.

there being nothing to prevent them from so doing. It was, however, the intention of parliament that a real and effectual monopoly should be created in favor of the Bank of England, and accordingly they determined to put down by law, the rivalry of any other company. In order to effect this, a clause was inserted in the act of 1709, renewing the charter of the bank, in these words—

“That during the continuance of the said corporation of the Governor and Company of the Bank of England, it shall not be lawful for any body politic or corporate whatsoever, erected or to be erected (other than the said Governor and Company of the Bank of England,) or for any other persons whatsoever united or to be united in covenants or partnerships, exceeding the number of six persons, in that part of Great Britain called England, *to borrow, owe, or take up any sum or sums of money on their bills or notes payable at demand*, or at any less time than six months from the borrowing thereof.”

19. This was the clause, which from that day to this, forbade the formation of any private bank of more than six persons; and we observe that the word “bank” is not even named in it. It does not say that no *bank* shall be formed of more than six persons, but it describes *banking* and forbids any partnership of more than six persons carrying on the business of banking; *i.e.*, of issuing promissory notes payable to bearer on demand. At that period this was the well understood meaning of Banking, and for a long time this clause was perfectly effectual for its purpose, and it did prevent any other joint stock bank being formed.

20. So matters continued for many years, until about 1742, several attempts were made to evade the words of the clause of 1709, and set up banks. In order, therefore, to stop up all loopholes in the act of 1709, and to be still more clear and explicit, the act of 1742 contains the following clause:

“And to prevent any doubt that may arise concerning the privilege or power given by former Acts of Parliament to the said Governor and Company of *exclusive banking*; and also in regard to erecting any other bank or banks by Parliament, or restraining

other persons from banking, during the continuance of the said privilege granted to the Governor and Company of the Bank of England as before recited, it is hereby further enacted and declared by the authority aforesaid, that it is the true intent and meaning of the Act, that no other Bank shall be erected, established, or allowed by Parliament, and that it shall not be lawful for any body politic or corporate whatsoever, erected or to be erected, or for any other persons whatsoever, united or to be united, in covenants or partnership, exceeding the number of six persons in that part of Great Britain called England, to *borrow, owe, or take up any sum or sums of money on their bills, or notes, payable at demand* or at any less time than six months from the borrowing thereof, during the continuance of such said privilege to the said Governor and Company, who are hereby declared to be and remain a corporation, with the privilege of *exclusive banking*, as before recited."

21. Still we observe that the intention of Parliament was to confer on the Bank of England, the exclusive monopoly of Banking. And this privilege of banking consisted in "*borrowing, owing, or taking up any sum or sums of money on their bills or notes payable at demand.*" Hence, we see that "Banking" meant the creation and issuing of "currency," and to prohibit persons from creating currency, was, in fact, to prohibit them from doing banking business. These words were devised with the utmost care, so as to prevent any other rival, in the most comprehensive manner possible. It was supposed that no legal ingenuity could devise an expedient to evade so extensive a prohibition. The form of words adopted in this Act was devised in reference to the methods of doing banking business at the time they were framed, and they were successful in preventing any rival bank being formed, so long as bankers adhered to that particular method of doing business. But about 30 years afterwards, bankers adopted a change in the method of doing their business so simple, and apparently so unimportant, as scarcely to deserve attention, which by a mere change in the form of doing their business, cut away the ground from under this Act, and was ultimately the means of destroying the monopoly of the bank.

22. Up till about the year 1772, bankers adhered to the original method of issuing promissory notes, payable to bearer, on demand. But about this time, they changed the form of making the purchases of bills. When their customers brought them bills to discount, instead of giving them their promissory notes payable to bearer on demand, they *wrote down the value of the bill to the credit of their customers in their books*. They then gave them books containing a number of printed forms. These forms were called **CHEQUES**, and were bills of exchange drawn upon the banker payable to bearer on demand. But it is usual for the drawer of a cheque to fill in the name of some one to whom it is made first payable. And these cheques may be put into circulation, exactly like bank notes.

23. These cheques are nothing whatever but bills of exchange upon the banker, payable to bearer on demand. There is, however, one peculiarity about them that must be noticed. In ordinary cases no man can be compelled to accept a bill drawn upon him for a debt, without his own consent, which is signified by his writing his name upon it. But, in the case of cheques, if this rule was enforced, it would have destroyed their utility, and they could never have been substituted for bank notes. A bank note bears on the face of it the obligation of the banker to pay it, but an unaccepted cheque, if it followed the usual law of bills of exchange, would be no obligation to pay without acceptance. Consequently, no man would have been safe in taking a cheque before he knew whether the banker would accept it or not. To obviate this difficulty, and to make a cheque as like a bank note as possible, it was established as a custom among bankers, that the *possession of a customer's funds by a banker is equivalent to acceptance*. Consequently, if a banker has funds of his customer in his hands, he is bound to pay all that customer's cheques, to the amount of the

funds in his hands, without notice and without acceptance, to the bearer on demand, exactly as if it was his own promissory note.

24. Hence, cheques are nothing but a substitute for bank notes. A bank note, in fact, is a double obligation, the one is an obligation to pay the customer, the original creditor, and the second is to pay the bearer, *i. e.*, any one to whom the original creditor may transfer the obligation. Now, the modern practice splits these obligations. The entry in the banker's books is the obligation to pay his customer, the permission to draw a cheque payable to bearer on demand, is the obligation to pay any one the customer may transfer the debt to. And the entry in the banker's books, together with the cheque, make up the bank note.

25. Hence, we see that although "Banking" originally consisted in issuing notes payable to bearer on demand, yet bankers devised a method of doing the very same thing under another form, and we must change the form of expression accordingly, to meet the altered form of doing business. Nor shall we have the least difficulty in finding an expression, which will include both forms. For though the business of banking consisted in discounting bills with their promissory notes payable to bearer on demand, we may express it thus:—that it consisted in buying debts with "promises to pay," and these "promises to pay" may be of two forms; 1st. Promissory notes payable to bearer on demand; 2dly. Figures written down to the credit of the customers, to be drawn against by cheques payable to bearer on demand. Up to the period when cheques were introduced the London bankers had very extensive issues of notes, but the method of doing business by cheques was found to have so many practical advantages over that by way of notes, that London bankers from that period universally discontinued the issue of notes, and adopted cheques.

26. The only practical difference between bank notes and cheques is this, that the former were, on the face of

them, direct obligations of the banker to pay the money stipulated; the latter were not direct obligations of the banker. The consequence is, that when cheques are transferred from hand to hand, it is usual to require the transferer to indorse them, so that if the banker refuses to pay them, the liability of the transferer may be preserved. In bank notes this is not usually done, because as the holder may demand payment for them on the instant from the bank, few persons expect that the bank will fail before payment is demanded, and consequently bank notes usually pass from hand to hand by simple delivery, without indorsement.

27. Both bank notes and cheques are subject to the general rule of law, which affects all instruments of credit, that whoever takes one in payment of a debt *without indorsement*, does so at his own peril, and has no remedy against the person he receives it from, if it is not paid. And the indorsement only preserves the liability for a very short period; in almost all cases not more than 24 hours. The law intends that all bank notes and cheques should be presented for payment within 24 hours. If the receiver of a bank note requires the transferer to endorse it, which is by no means unfrequently done, and if, on presenting it within reasonable time, he finds the banker has failed, he has his remedy against the transferer, just exactly as if it was a cheque. On the other hand, if he delays presenting it beyond a reasonable time, and then finds the banker has failed, he has no remedy against the transferer, either in the case of an indorsed bank note or a cheque.

28. We see, then, that the modern system of banking, by means of cheques, is exactly the same in principle as the former method of bank notes, only it is rather varied in form. In each case the business of banking consists in creating liabilities. The different forms, however, of these liabilities mislead writers extremely, who are not familiar with the mode in which they are created, into very erroneous ideas on the subject, and we will now

exhibit the mode in which each of them is stated. Let us deal with small figures, as that will exhibit the principle as well as larger ones. Leaving out of consideration the banker's own property or capital, let us suppose that he has deposits in cash from his customers A, B, C, D, &c., to the amount of £10,000. Then his accounts would stand as follows,

LIABILITIES.		ASSETS.	
To balances on drawing accounts	£10,000	To cash in hand . .	£10,000

Now, suppose that others of his customers, a, b, c, &c., bring him bills to discount, that is, offer him debts for sale, to the amount of £5,000. For the sake of simplicity, let them be twelve months' bills, and the rate of discount 5 per cent. Then if he agrees to buy them, in the former method of banking, he would give them £4,750 in his own promissory notes, retaining the £250 as his profit, and his accounts would then stand thus:—

LIABILITIES.		ASSETS.	
To customers' balances .	£10,000	By cash in hand . .	£10,000
To notes in circulation .	4,750	By bills of exchange .	5,000
	<u>£14,750</u>		<u>£15,000</u>

In the modern form, instead of giving his own promissory notes to the amount of £4,750, he would write down £5,000 to the credit of his customers, and at the same time write down £250 to their debit, and then his accounts would stand thus:—

LIABILITIES.		ASSETS.	
To customers' balances .	£14,750	By cash in hand . .	£10,000
	<u>£14,750</u>	By bills of exchange .	5,000
			<u>£15,000</u>

29. Now, in examining these two forms of accounts, though they are in reality only two different methods of doing the same thing, a very striking difference is apparent. In the first it is apparent on the face of them, that the banker has issued £4,750 of notes. That is, he has created liabilities against himself to that amount, by

buying bills of exchange or debts. Now, he is equally liable to demands for immediate payment, both from the customers who have deposited cash with him, and from those who hold his notes. Consequently he must be very careful that he does not multiply his liabilities to so great an extent, that more cash may be demanded from him than he possesses. And to what extent he may safely multiply his liabilities, is a matter of pure experience and judgment.

30. In the second form of making up the accounts, as soon as the banker has agreed to buy the debts, and placed the sums to his customers' credit, these figures become "balances on drawing accounts," and are his promises to pay, equally with the figures which represent actual deposits in cash, and are undistinguishable from them. Both sets of customers, A, B, C, &c., and a, b, c, &c., have an equal right to call upon him for instant payment of their "balances," or to draw cheques, and put them in circulation like bank notes. Hence, as before, the business of banking consists in creating liabilities, and the extent of liabilities the banker may create, depends purely on the amount of actual cash that he may expect to be demanded from him.

81. Of late years, it has been the practice of joint stock banks to publish their accounts; but those who do not know how banking accounts are made up, may draw very erroneous conclusions from them. Thus, when the accounts of the great London Joint Stock Banks are published, shewing that they have balances or deposits of £9,000,000, many persons might imagine that these figures mean that they have nine millions of *cash* deposited with them to trade with. But this would be a very great mistake indeed, for a very large proportion of these "balances on drawing accounts," consist merely of figures placed to the credit of their customers on the discount of bills, which are exactly equivalent to bank notes. Nor is it possible for any ingenuity to discover what proportion consists of actual cash lodged by custo-

mers, and what proportion consists merely of credit. But the stability of the bank depends upon a due proportion being kept between them, and it might very well happen, that while the "deposits" were apparently mounting up, and might lead many persons to believe that the actual quantity of cash was increased, it might be nothing, perhaps, but a dangerous extension of credit. And if this were carried to too great a length, the bank might be in the most dangerous position, just when it was apparently most flourishing. A private banker on a large scale often has an application to place £10,000, or more, to the credit of a customer; if he does this, it immediately counts as a "deposit" in banking accounts. Again, it is a very possible case, that a large railway company might request their banker to place £100,000 to their credit. Now, if the bank does this, such a transaction goes to swell up the figures of "deposits" in their published accounts, which may lead to very erroneous inferences by the public, who do not know the mode in which banking accounts are made up.

32. A consideration of this example also shows the very great misconception that is likely to be produced by an expression which is very often used regarding bankers, that they are merely agents between persons who want to lend, and those who want to borrow. This is not true in the ordinary sense of the words lending and borrowing, because in ordinary cases of lending and borrowing the lender deprives himself of the use of the capital he lends. But in ordinary banking, both parties have the complete use of the capital. The customer lends his money to the banker, and yet has the free use of it—the banker employs that money in promoting trade; upon the strength of its being deposited with him he buys debts with his "promises to pay," and the person who sells the debt, has the free use of the very coin which the lender has the same right to demand.

33. The common notion of banking is, that it consists in lending money upon the security of bills of exchange.

Such an idea, however, is profoundly erroneous, as it consists in buying debts with "promises to pay," or creating liabilities. And the contingency is, that he may be called upon to pay them; no doubt, theoretically speaking, he is liable to be called upon to pay all those liabilities at a moment's notice, just in the same way as it is theoretically possible that all the lives insured in a life insurance company may drop at the same moment; or it is theoretically possible, that all the property insured in an office may be destroyed by fire at the same moment; but no one expects such a contingency to happen. Banking is like insurance, the sum in cash retained by the banker is what his experience tells him is sufficient to ensure his being able to meet any calls which are likely to be made upon him.

34. In order to add further proof if possible of the utter fallacy of the common notion that discounting bills is borrowing money, we may state that when a customer has discounted a bill with his banker, he has parted with all property in it, just as with any other article of sale. The bill becomes the absolute property of the banker, which he may sell again, or pledge, or deal with in any manner that suits his own interests best. Now, if it was a loan from the banker to his customer, it would manifestly be the duty of the customer, to repay the loan in due time, and get back his bills, which would be merely deposited with the banker as security, and should be restored when the loan was paid, and which the banker would have no right to part with. But this is not the case. The banker does not receive payment from his customer, but from the acceptor of the bill, and he has perfect right if he pleases, to sell the debt to any one else. On the other hand, in some few instances, a customer does sometimes borrow money on the security of bills, and in these cases, the customer repays the loan and receives back his bills. But such cases are very rare, and to be distinguished from the ordinary business of discounting bills.

35. The mode, therefore, in which the modern form of making up banking accounts leads to deceptive appearances, is, that when persons who are not conversant with the subject, see that a bank has so much in balances on customers' accounts, they are apt to believe that the bank has that quantity of money, actually to trade with. But the fact is, that these balances arise from the bank *having* traded with its cash, and reared up a structure of credit on its basis. We are persuaded that much of the misconception that prevails upon this subject arises from the belief that cheques are only drawn against actual cash deposited with the banker, and that bank notes are founded merely on his credit. Such a notion, however, is perfectly delusive. Bankers invariably buy bills of exchange with their "promises to pay," and not with coin, and cheques drawn against their promise to pay are as purely based upon the banker's credit as bank notes are.

36. And it is exactly in this that the distinction between a *banker* and a bill broker consists. A bill broker buys bills of exchange with actual cash, and, therefore, the quantity he buys can never exceed the quantity of cash he has. On the contrary a banker always buys bills with his "promise to pay" cash, consequently the only limit he need impose upon his business, is that which his own judgment may suggest to him, to keep himself in a condition to meet any demands that may be made upon him.

37. It follows from these considerations that cheques are merely another form of bank notes, and were intended as a substitute for them. In all cases where a cheque is now used a bank note would have been necessary if cheques had not been invented. But they are not exactly equivalent, for in many cases where bank notes would pass, cheques will not pass. Consequently, though in every case where a cheque passes, bank notes would pass, the converse is not true that in every case where bank notes pass, cheques would pass, and the system of cheques

does not supersede coin to so great an extent as bank notes do. Now, banks which issue bank notes are named banks of issue, and it is sometimes supposed that only these banks deal with their credit; and that other banks deal with actual cash. The preceding details show how utterly erroneous such notions are. All banks are "banks of issue," in a scientific sense, at least all those in this country which do banking business by purchasing bills of exchange. And the supposition that the legislature can prevent banks dealing in credit, by prohibiting the issue of bank notes, is one of the merest delusions that ever prevailed.

38. From the foregoing considerations we see that a merchant deals *with* credit, and a banker deals *in* credit. A merchant brings him debts payable some time after date, for sale, and by a flourish of his pen, the banker transmutes these into debts payable instantly, which have precisely the same effect in commerce as so many sovereigns. He reaps exactly the same profit by creating a credit in favor of his customer, as if he gave him the actual cash. From this it manifestly follows, that **BANKING CREDIT IS BANKING CAPITAL.**

39. Now, in the preceding section we have proved that mercantile credit is mercantile capital, and consequently, as all credit is either banking or mercantile, we arrive at this general conclusion, that **CREDIT IS CAPITAL.**

40. The preceding details also show the prodigious error of those who think that banking does not add to capital, that it only distributes existing capital. It is unquestionably true that no mode of banking can create actual gold sovereigns. But if by means of their credit, bankers can circulate their promises to pay, and if these be voluntarily received and accepted by the community at large, at exactly the same value as if they were actual sovereigns, then just by so much as they exceed in number the quantity of actual sovereigns in the banker's possession, they are to all intents and purposes an *addition*

to existing capital. For not only does he save the use of the actual coin in an immense multitude of instances where it would be required if banking did not exist, and liberates it, and enables it to be applied to promote commerce, which is in its practical effects identical with an addition of actual coin to that extent, but by the extra multiplication of his promises to pay over and above that, he is enabled to make what is to all intents and purposes a further addition to the moving power of commerce to an enormous extent.

41. Banking is, therefore, the most potent engine for the increase of the moving power of any given quantity of actual capital that it is possible to devise, consistently with keeping up the value of the currency at its level with bullion. John Law says most justly, "The introduction of credit by means of a bank, augments the quantity of money more in one year, than a prosperous commerce could do in ten." * And just as banking spreads more extensively, does it multiply the producing power of the community. We have already noticed the great economising power of railroads in diminishing the quantity of capital required to supply any given demand for commodities; now, an extension of banking acts precisely in an analogous manner, but to a much greater degree; for, not only does it economize the actual substance to a very great extent, but it makes the "promise to pay" of equivalent value with the actual payment. And it is just in this multiplying power of capital that the principal danger of too rapid an extension of banking consists. The rate of discount always depends upon the proportion between actual capital and the demand for it, or on the debts offered for sale. A sudden change in the proportion of these, causes the most violent fluctuations in the rate of discount. If an unusual quantity of capital is thrown too suddenly upon the market, the only result must be a rapid and extreme fall in

* Second Memoire sur les Banques. Œuvres p. 609. Edit. Guillaumin.

the rate of discount. Now, a too rapid extension of banking has precisely the same effects as throwing a vast quantity of capital suddenly on the market. For, not only do the actual operations of banking have all the practical effects of adding to the existing capital, but to that will be added all the evil effects of over-competition, an unnaturally low rate of discount, thereby a depreciation of the currency; an export of bullion; a joint-stock bubble mania, with all its rogueries; then a collapse, and commercial ruin.

42. Great and inestimable, therefore, as are the blessings and advantages of banking, there is no department of trade which is likely to produce more fatal consequences to the public by too rapid an extension of it, and too rapid a multiplication of banks. There is no *mania* which should be looked to with a more jealous eye by the public, or more carefully guarded against by the legislature, than a bank mania, nor one which is more properly the subject of regulation by law.

43. We have seen that the only limit to which the banker must restrain his purchases of debts with his "promises to pay," is to preserve a safe and sufficient margin between the actual coin he keeps, and the number of "promises to pay" he may be called upon to fulfil. But, even supposing that his accounts are operated upon, that his customers put into circulation orders upon him to pay cash to the bearer on demand, still it does not follow that he will have to pay these orders in actual cash. He has several chances in his favor that he will *not* have to do so. In order to save repetition, let us consider the case not of a single bank, but of several banks transacting business on the same principles, in the same locality. Each of them will have a certain amount of deposits in coin, and each of them will do business by buying debts with their "promises to pay." Now, let us consider the chances there are, that operations may be carried on without any demand for the actual coin. First, the cus-

tomers of one bank may draw a cheque in favor of some one else, who may also be a customer of the same bank, and that customer may only pay it into his own account, and the operation will be merely a transfer of figures from one account to another, but yet will be equally effectual as if the actual coin passed. Secondly, he may pay a cheque to a customer of another bank, and that customer may pay it into his account with his own banker, and desire him to get payment of it. But the same thing may probably happen to the first banker, one of his customers may pay into his account a cheque drawn upon the second banker. When these two bankers meet, therefore, to balance accounts, they will set off these mutual claims one against the other, and pay the difference only in coin. But yet the operations are equally effectual as if the actual coin passed; and there is no man who understands the right use of language and reason, who can deny that these mutual claims are as much circulating medium as if they were paid in coin. The same manifestly holds good of any number of bankers; and the great art in banking is taking all these chances into consideration, observing, in the first place, how many payments are actually demanded; and, secondly, if they be demanded, what proportion of them are settled and cancelled by cross claims and obligations on other banks, so as to save the use of actual coin, that a banker keeps himself in a state of propriety and safety. And these, and these only, are the considerations which limit his power of buying debts with "promises to pay."

44. Now, as we have shewn that these debts may all be settled by the mere payment of differences between the mutual claims, it might so happen that they might all be equal, and no coin at all pass. It is perfectly possible, therefore, that any amount of business might be settled without any coin at all. Consequently, we observe that this is a very strong confirmation of what we have already said, that the quantity of money necessary in any country depends very much on the method

of doing business, and has no relation to the quantity of commodities. It is very common among some writers to say that the prices of commodities depends upon the quantity of money and the quantity of commodities; but such ideas are mere visionary chimeras.

45. We may anticipate here an objection which perhaps might appear more fitly to belong to the next section, where we shall examine certain views which are prevalent regarding bills of exchange. Many persons say that bills of exchange are not currency, because they require to be discharged in money. It is perfectly true that all bills of exchange must be expressed to be payable in money, but it is a very grievous mistake to suppose that they are all paid in money. The immense majority of commercial bills of exchange are not paid in money, but by figures in bankers' books. Thus, most men in commerce have debts due by them, *i.e.*, acceptances, and also debts due to them. These, of course, generally fall due at different dates. Now, when a trader's acceptance is falling due, he takes some of the debts due to him to his banker, and sells them to him. The banker buys them, as we have already explained, by writing so many figures to his credit. When his own acceptance falls due and is presented to him for payment, he draws a cheque upon his banker, and if the holder of the bill is a customer of the same banker, the matter is settled by a mere transfer in the banker's books; if he is the customer of another banker, the two bankers probably have an exchange of debts, arising out of similar transactions, on both their parts, and the debts are settled with the payment of no more coin than the difference. Now, this is the regular practice of banking, this is the way in which the vast majority of bills of exchange in commerce are paid, and consequently the whole system may go on for an indefinite time, and to indefinite extent, without a single coin being required.

46. There is in London an office for the express purpose of exchanging the mutual claims of those bankers

upon each other who are members of it, and we will now describe the method of bankers settling their mutual claims. This office is called the Clearing House.

47. Every bank in London which is not a member of the clearing house, sends out, the first thing in the morning, to collect the obligations it holds due from all other banks. The Metropolis is portioned out into certain "walks," and it is the duty of a particular clerk to collect all the bills, cheques, &c., within his walk. As clerks start from each bank simultaneously, every bank must be prepared to meet the claims of every other bank in the Metropolis. These are called *bankers' charges*, and they are paid usually in bank notes, in some cases by cheques drawn upon the Bank of England. The slightest reflection will show the waste of Bank of England notes caused by this barbarous and clumsy method of settling bankers' charges. It is evident that a very large amount of bank notes might be saved, if the bankers had some method of balancing their claims against each other, and settling only the difference in bank notes. What the amount of bank notes which are positively wasted by this method may be, is not very easy to tell. It was stated in evidence before the Committee of the House of Commons on one occasion, that one bank alone, the London and Westminster, was obliged to keep £150,000 of notes for this very purpose, which by a better method might have been set free, and would have, to all intents and purposes, been so much additional trading capital. Now, if this bank alone was obliged to keep this enormous sum unprofitable, what must have been the total amount wasted in this manner by all the bankers? We cannot believe that we at all over-estimate it if we place it at least at £1,000,000.

48. About 1775, the inconvenience of sending out to collect these charges led a number of the city bankers to organize an exchange among themselves, on a similar plan to that already practised among the banks in Edinburgh. They met in a room, and exchanged their mutual

claims against each other, and paid only the difference in cash, or bank notes. It is stated in the Bullion Report,* that in the year 1810, there were 46 bankers who cleared; that the average amount of drafts, &c., passed through the clearing house every day was about £4,700,000, and that all the balances on this account were settled by about £220,000 in Bank notes. The clearing house was merely an assemblage of private bankers; the Bank of England was never admitted to it, and is not to this day. When the joint stock banks were instituted in the city, they were equally excluded until 1854, when the intolerable inconvenience caused to them by the large amount of notes they had to keep idle to meet the "charges," set a question afloat of organizing another clearing house among themselves. Moreover, it is said, that the private bankers themselves felt the inconvenience of the heavy "charges" of the joint stock banks. Partly owing to these circumstances, and partly, we hope, owing to the feeling against the joint stock banks having abated, most of them have now been admitted into the clearing house. At the present time there are twenty-five private bankers and eight joint stock banks in the clearing house.

49. The mode of doing business is as follows. The bills and cheques which each banker holds on the other clearing banks, are sorted in separate parcels; and at 10·30, a clerk from each bank arrives at the clearing house. He delivers to each of the other clerks the obligations he has against his house, and receives from each the obligations due from his own. When these obligations are interchanged, each clerk returns to his own bank. The same process is repeated at 2·30. Each bank has till 4·45 to decide whether it will honor the drafts upon it; if it does not return any drafts upon it before that hour, it is held to have made itself liable on them to the clearing house. At 4·45 the business closes, and the accounts are made up; and so admirable is the system, that in

*Evidence of Mr. Thomas. p. 151.

settlement of the claims *not a single Bank note or sovereign passes.*

50. Each clearing bank keeps an account at the Bank of England, and the Inspector of the clearing house also keeps one. Printed lists of the clearing banks are made out for each bank, with its own name at the head, with the word "debtor" on the one side and "creditor" on the other. The clerk of the clearing house then makes up the accounts between each bank, and the *difference* only is entered in the balance sheet, according as it is debtor or creditor. A balance is then struck between the debtor and creditor column, and the paper delivered to the clerk, who takes it back to his own bank. The balance then is not paid to or received from the other bankers, as formerly, but it is settled with the clearing house, which keeps an account itself with the Bank of England. The accounts are settled by means of a species of cheque, appropriated to the purpose, called *transfer tickets*. They are of two colors, white and green; the white when the bank has to pay a balance to the clearing house, the green when it has to receive a balance from it. By this beautifully organized system the amount of several millions is settled daily, without the intervention of a single bank note.

51. The most surprising thing, however, about this system is that only about one half of the city banks are in the clearing house. None of the banks beyond the city walls are members of it, and the Bank of England is not a member of it. So that all these banks have to settle their claims upon the other banks in the manner we have described. Is not this a most extraordinary circumstance to be the case in London in the middle of the nineteenth century?

52. The two methods which London bankers have of settling their mutual claims, which we have described, by collecting the charges in the morning, and by the clearing house, suggest several important reflections upon the circulating medium, and the Act of 1844. That Act fixed the sum of £14,000,000 as the limit below which the

requirements of business would probably not permit the internal circulation to fall. But there is this objection to it, that it was *fixed with reference to a particular method of doing business*. If all the London bankers were admitted to the clearing house, there would immediately be at least £1,000,000 of bank notes disengaged from business, and they would either disappear from circulation altogether, or else they might be employed as fresh capital in discounting bills and making loans. On the other hand, let us suppose the clearing house dissolved, and the clearing banks to revert to the barbarous method of settling their mutual claims practised by the non-clearing banks, at least one million, probably considerably more, of bank notes would be required to settle their claims. We are satisfied that between these two extreme methods of transacting business—either there being no clearing house at all, and all the banks demanding payment from each other of their claims in bank notes, and, on the other hand, all the banks entering the clearing house, there would be a difference of bank notes necessary to transact the same amount of business of not less than £3,000,000. Now, it is perfectly manifest, that if the clearing house were dissolved, the additional quantity of bank notes necessary to transact business would not in any way affect prices or business; nor if all the banks were to enter it, could the quantity of bank notes withdrawn from circulation affect prices or business. Consequently, we observe, that the quantity of bank notes requisite to transact business, depends very much on the particular method of settling claims.

53. The operations of the clearing house also enable us to dispel a very prevalent error among those persons who maintain that bills of exchange are not “currency” or circulating medium, because they can only be discharged by payment of money. Even if such an assertion were true, it would not affect the question in any way, but the assertion itself is wholly erroneous. It is not true, that bills of exchange can only be discharged

by payment in money. Bills of exchange to the amount of £1,500,000 are daily discharged without any coin whatever, just in the same manner as cheques are. A bill of exchange, on the day it matures, becomes a cheque; a cheque is nothing but a bill of exchange payable to bearer on demand. Now, let us take the case of a wholesale dealer who accepts bills to a manufacturer, and draws bills upon retail dealers. When he opens a discount account with his banker, he brings the bills he draws upon his own customers, the retail dealers, and sells them to his banker. He also makes the bills drawn upon himself payable at his banker's, and the proceeds of the bills he sold are appropriated to the payment of the bills he has to meet. Now, he knows when the bills he has accepted fall due, and he takes care to sell some bills to his banker to meet them. The banker, as usual, buys these bills, by merely writing so many figures—so many “promises to pay”—to the credit of his customer. Now, if this banker is a member of the clearing house, and the banker who presents his customer's acceptances for payment, is also a member of it, they are presented through the clearing house, and fall into the mighty mass of transactions which are settled by its means, without any intervention of coin, or bank notes.

54. Now, when we see that cheques are merely substitutes for bank notes, that in every case where a cheque now passes, bank notes would be required if cheques had not existed; when we also see that a bill of exchange on the day it is payable becomes a cheque, which is equivalent to a bank note, it follows very clearly that all the obligations interchanged at the clearing house form an integral part of the circulating medium. Their being exchanged at the clearing house can make no difference to what they would be if they were presented and paid by each banker. For they have all done their duty *before* they arrive at the clearing house, they have caused commodities to circulate, perhaps many more times than once before they come to be discharged.

55. We see, then, how utterly futile it is to attempt to form any estimate of the amount of paper currency in this country. Returns may be made of the stamps issued for bank notes, bills of exchange, and promissory notes; but how is it possible ever to discover the amount of cheques in circulation? If this cannot be done, it is useless to try to estimate the amount of the paper currency; and still more impossible is it to control the issue of paper, while the power of drawing cheques is unrestricted.

56. The great and important portion of the currency which consists of cheques has not been sufficiently appreciated. The attention of speakers, writers, and legislators, on the *paper currency*, has been almost exclusively directed to bank notes; whereas all the ideas involved in bank notes are, with a small change in the form of expression, applicable to cheques; and there is no operation whatever which a bank can promote by means of bank notes which it cannot with equal efficacy perform by means of cheques. If it wishes to advance a speculation, instead of giving its customer so many of its notes, it promises to honor his cheques to an equal amount. In Scotland the system of bank notes chiefly prevails; and cheques are of more recent introduction, and more sparingly used than in England. In this country, cheques have very greatly superseded bank notes, and in many respects are far superior to them. Among other reasons, they are not such ready weapons against a bank in the hands of rivals and enemies. It has been by no means an unheard-of measure of hostility against a bank which issues notes, for its rivals to buy them up in all directions, and, having accumulated a considerable amount of them, to present them for payment suddenly in a mass, in the hopes that the bank may be unprepared to meet, on the instant, so great a demand for gold, and be ruined. With cheques this method of hostility is more difficult. It is not easy to conceive that any person could go round to all the

customers of a bank, and accumulate such an amount of cheques, as to render a demand for payment of them in gold formidable to the bank. At all events, it would require a much more elaborate and deep-laid plot to injure a bank by the method of cheques, than of bank notes.

57. We have already more than once noticed a very inaccurate notion that is very common, that traders who discount bills with their bankers, carry on business upon borrowed money. We have shewn that it is nothing but the sale of a debt, which grew out of a previous transaction. When this is done, the original debtor becomes the principal debtor to the banker, and the trader only a security in case of non-payment. Now, if the trader deals with ten other traders, and sells their debts to him to the bank, they become so many principal debtors to the bank, and are of course bound to provide funds to meet each his own debt. But as it is possible that some of them may fail in doing so, the banker requires his customer to keep a certain balance in his hands to meet such contingencies. Now, it is evident that so long as bills are generated by actual sales, they must be limited by them. But a practice has sprung up of manufacturing sham debts, and selling them to bankers as real debts, which has been the cause of many calamities. It has sometimes been supposed that it is only tradesmen in failing circumstances, who resort to this practice, but unfortunately it is not so. If it were so, the evil might be confined to a narrow compass, comparatively speaking. It is in times of great commercial agitation, generally speaking, that this takes place, to the most ruinous extent, when speculation runs high. A clever trader gets his friends to accommodate him with their names, he then goes to his banker and discounts this paper with him as real. Now, this is, in truth, *borrowing* money from the bank. In such a case as this, the borrower is bound by law to provide funds, to meet the bill when due, and the acceptor would never have put his name to the bill, if

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he really expected to have to pay it, and directly he is called upon to do so, he has his remedy against the drawer.

58. Nothing can be more dangerous than for a bank to countenance a customer dealing in accommodation paper. If it chooses to take a particular bill on a special occasion, because it prefers to have a name as a security for an advance in that form, that is a different matter. But if such a thing goes on to any extent, it will almost infallibly terminate in a disaster to the bank. A sanguine projector gets his friends to accommodate him with their names upon bills which he discounts, undertaking, of course, to provide funds to meet them. This goes on well at first, the acceptances are punctually met, the bank in the meantime being totally in the dark as to who it is that finds the funds to meet the bills. The drawer having met the first bills, and having got a good name by the apparent punctuality of his bills, goes on deeper and deeper, and widening the sphere of his operations, till at last the returns fail to enable him to meet his friends' engagements, and the bubble bursts.

59. It is easy to show how much more dangerous it is for a bank to discount accommodation paper than real paper. Suppose it has discounted B's accommodation acceptance to A, then B, on the face of the instrument, is the principal debtor to the bank, which will of course make B pay, but as it is A's duty to provide the funds to enable B to pay, if he fails to do so, B has his immediate remedy over against A. So that if the bank presses B, he will immediately press A, just as every other surety is entitled to recover from his principal. But if A be not in a condition to pay up immediately, and has other bills current in the bank, the latter dare not press B, for fear of ruining A, and inducing a greater catastrophe. Now, if A gets ten of his friends to accommodate him with their names, and discounts these bills at his banker's, it is A's duty to provide funds to meet every one of these bills at maturity. If the bills were real, it would be the duty of

the ten acceptors to provide funds to meet them, and the bank would have ten real principal debtors, nor would the bank hesitate to press any one of them who failed in his engagement. As all these accommodation acceptors were most probably induced to lend their names to A on his promise to provide funds to protect them, they in all probability took no pains to provide any funds to meet them, as few persons would put their names on an accommodation bill if they really thought they would have to pay it, and they are most probably ignorant of each other's transactions. In the case of real bills, then, the bank would have ten persons who would each take care to be in a position to meet his own engagement; in the case of accommodation paper, there is only one person to meet the engagements of ten. Furthermore if one of ten real acceptors fails in his engagement, the bank can safely press the drawer, but if the drawer of the accommodation bills fails to meet any one of the ten acceptances, and the bank suddenly discovers that it is an accommodation bill, and they are under large advances to the drawer, they dare not for their own safety press the acceptor, because he will of course have immediate recourse against his debtor, and the whole fabric will probably tumble down like a house of cards. Hence, the chances of disaster are much greater when there is only one person to meet so many engagements, than when there are so many bound each to meet his own. These considerations show how extremely dangerous it is for any bank to offer facilities for discounting accommodation paper.

60. We see, then, that the real danger to a bank in being led into discounting accommodation paper, is that the position of principal and surety is reversed. They are deceived as to who the real debtor is, and who are the real sureties; being precisely the reverse to what they appear to be, which makes a very great difference in the security to the holder of the bills. To advance money by way of cash credit, or by loan with security, is quite a different affair, because then the bank knows exactly

what it is doing, and as soon as anything occurs amiss, it knows the remedy to be adopted. Moreover, it never permits the advance to exceed a certain definite limit, but it never can tell to what length it may be inveigled into discounting accommodation paper, until some commercial reverse happens, when it may discover that its customer has been carrying on some great speculative operation, with capital borrowed from it alone.

61. The insurmountable objection, therefore, to this class of paper is the dangerous and boundless facility it affords for raising money for speculative purposes. And there is much reason to fear that this pernicious system prevails to a much greater extent than is generally supposed. All the great commercial catastrophes, which have within recent times scattered such misery and desolation throughout the country, have been preceded and greatly caused by the abuses of this species of paper. All the acts of the legislature to lay the issues of banks under stringent restrictions are perfectly futile, unless some effectual measures are taken to restrain the negotiation of accommodation paper, which can flourish quite as well under a metallic currency as under a paper one. However, we cannot enter into the subject in greater detail here, as it would be beyond the limits of this work, and we must refer to what we have said at greater length elsewhere.*

62. Seeing, then, that the nature of discounting bills of exchange is buying debts, which are to be considered just like any other articles of commerce, it follows that the same laws govern their exchangeable relations, as those of any other quantities. The first duty of a banker is to maintain his own position, which he can only do by maintaining certain proportions between his actual cash and his promises to pay, or his liabilities, and that proportion must vary from time to time, according to circumstances. In times of a general failure of credit, he must maintain

a very much larger portion of cash compared to liabilities, than in times of general confidence. Under such circumstances his duty is to *contract* his liabilities, which he must do either by refusing to buy debts altogether, or else by giving a lower price for them, *i. e.*, raising the rate of discount. And a general rise of the rate of discount has a tendency to discourage the offering of debts for sale, just as low price of anything else discourages its being offered for sale, except by those who positively require the cash.

63. On the other hand, this lowering of the price of debts, *i. e.*, this increase in the value of money, or the raising of the rate of discount, has an inevitable tendency to attract bullion from where it is more abundant, *i. e.*, where the rate of discount is lower. Wherever debts are to be bought cheap, thither will bullion fly to buy them; wherever debts are sold dear, that is, wherever money is to be bought cheap, thither will debts fly to be sold, and and there will competitors be to buy money. Consequently, it is an infallible law of nature, that whenever the price of debts differs in two markets by more than sufficient to defray the expense of sending bullion, it will cause an immediate flow of bullion to that market where debts are to be bought cheapest, *i. e.*, where the rate of discount is highest. That is to say, if the rate of discount at Paris is greater than at London, by more than sufficient to cover the expense of sending bullion, debts will fly from Paris to London to buy bullion, and bullion will fly from London to Paris to buy debts. The exchangeable relations of money and debts will obey exactly the same laws as the exchangeable relations of money and wheat. Consequently, if left free and uncontrolled, the prices of debts have a natural tendency towards equilibrium in different markets

THEORY OF CREDIT.

SECTION III.

EXAMINATION OF THE OPINIONS OF MODERN POLITICAL ECONOMISTS ON THE SUBJECT OF CREDIT.

1. We have in the two preceding sections confined ourselves to giving an account of the actual details of the great system of credit, and have avoided controversy as much as possible. Any one, however, who is acquainted with the writings of the principal political economists from the days of Turgot to the present time, will see that these sections contain the complete overthrow of the established opinions on the subject. It becomes our duty, therefore, to examine their views, and point out wherein the fallacy lies, which is so extensively diffused.

2. The modern doctrines of credit take their rise from a writing of Turgot's in 1749, when he was still at college, and only twenty-two years of age. It is entitled a "*Lettre à M. l'Abbé de Cice sur le Papier supplié à la Monnaie,*" and was an attempt to point out and refute the fallacy

of John Law's system. Unfortunately, however, Turgot never perceived in what the peculiarity of Law's system consisted, and his letter would have no claim to be noticed here, but that it contains the expression which has been the keynote of a fallacy which has been sedulously propagated from that day to this, by a long series of writers, both in France and England. He says,* "En un mot, tout crédit est un emprunt." "In a word, all credit is a loan." This most unfortunate expression is the fundamental fallacy, which runs through all the chief writers on Political Economy, from that day to this—That credit is merely a *loan*. The utter fallacy of such an idea has been fully exhibited in the preceding sections.

3. Adopting this most unhappy phrase of Turgot, which is an entire misconception of the nature of credit, J. B. Say has pushed the matter further, and has invented another phrase, which is repeated over and over again, in almost all the works on Political Economy in this country. He says,† "On s'imagine quelquefois que le crédit multiplie les capitaux. Cette erreur qui se trouve fréquemment reproduite dans une foule d'ouvrages, dont quelques-uns sont même écrits *ex professo* sur l'économie politique, suppose une ignorance absolue de la nature et des fonctions des capitaux. Un capital est toujours une valeur réelle et fixée dans une matière; car les produits immatériels ne sont pas susceptibles d'accumulation, *ou un produit matériel ne saurait être en deux endroits à la fois, et servir à deux personnes en même temps.*" He considers credit to be a *loan* of some material product by one person to another, and then says, how can this same value, *i.e.*, the same material product, be in two places at once? And this sentence has become a standing piece of ridicule to fling at those writers who maintain that credit is

* Œuvres de Turgot. Vol. i. p. 96. Edit. Guillaumin. I regret to say that M. Eugene Daire, the author of the Historical notice of Turgot in this edition, has completely misunderstood Law's system. Vide p. 19.

† Traité d'Economie Politique. p. 392. Edit. Guillaumin. See also his Cours d'Economie Politique.

capital. But who said that a thing could be in two places at once? And what has this got to do with credit? An operation on credit is where an operation is effected by some instrument of credit, instead of by money. What senseless jargon it is, to say that "a thing cannot be in two places at once," is an expression applicable to such a transaction.

4. This erroneous notion of credit might be pardonable in writers who considered capital to be confined to some material product, such as land, beasts, corn, or money. But in a writer who expressly admits immaterial products to be capital, such an error is not excusable, because credit is manifestly a species of immaterial capital, and one which we shall shew to be of enormous value.

5. We will now make an extract from Mr. Thornton's Essay on Paper Credit, which shews some curious inconsistencies. He says,* "It may conduce to the prevention of error in the subsequent discussions, to define in this place what is meant by commercial capital. This consists, first, in the goods (part of them in the course of manufacture) which are in the hands of our manufacturers and dealers, and are in their way to consumption. The amount of these is necessarily larger or smaller in proportion as the general expenditure is more or less considerable, and in proportion also as commodities pass more or less quickly into the hands of the consumers. It further consists in the ships, buildings, machinery, and other dead stock, maintained for the purpose of carrying on our manufactures and commerce, under which head may be included the gold found necessary for the purposes of commerce, but at all times forming a very small item in this great account. IT COMPREHENDS ALSO THE DEBTS DUE TO OUR TRADERS for goods sold and delivered by them on credit, debts finally to be discharged by articles of value given in return." Now, it is perfectly manifest, that if the "debt" is capital to the merchant

* p. 19.

who has sold the goods, it is equally true that the "credit" is capital to the trader who bought them with it.

6. Mr. Thornton then proceeds—

"Commercial Capital, let it then be understood, consists not in paper, and is not augmented by the multiplication of this medium of payment. In one sense, indeed, it may be increased by paper; I mean that the nominal value of the existing goods may be enlarged through a reduction which is caused by paper in the value of that standard by which all property is estimated. The paper itself forms no part of the estimate.

"This mode of computing the amount of the natural capital engaged in commerce is substantially the same with that in which each commercial man estimates the value of his own property. Paper constitutes, it is true, an article on the credit side of the books of some men, but it forms an exactly equal item on the debit side of the books of others. It constitutes, therefore, on the whole, neither a debit nor a credit. *The banker who issues £20,000 in notes, and lends in consequence £20,000 to the merchants, on the security of bills accepted by them, states himself in his books to be debtor to the various holders of his notes to the extent of the sum in question, and states himself to be the creditor of the acceptors of the bills in his possession, to the same amount. His valuation, therefore, of his own property is the same as if neither the bills nor the bank notes had any existence.*"

7. We cannot help expressing our surprise that the latter part of this extract, in italics, should have emanated from so able a person as Mr. Thornton. Nothing can be more erroneous than to say, that when a banker issues his own notes against mercantile securities, the debt and the credit are equal. Suppose that a merchant brings £20,000 of bills, (let them be 12 months' bills, for the sake of simplicity,) to his banker, to be discounted at the rate of 5 per cent. The banker does not give him £20,000 of his notes in exchange for the bills, he only gives £19,000, so that if all these notes were immediately issued the banker would only be debtor to the amount of £19,000, and he would be creditor to the amount of £20,000, thereby leaving a clear sum of £1,000, which would be his own property. The result of such an operation would be,

that the banker's liability would be £19,000, his assets £20,000, leaving a clear profit of £1,000 to himself.

8. Mr. Thornton proceeds—

“Again, the merchants in making their estimate of property deduct the bills payable by themselves which are in the drawer of the banker, and add to their estimate the notes of the banker which are in their own drawer, so that the valuation likewise of the capital of the merchants is the same as if the paper had no existence. The use of paper does not, therefore, introduce any principle of delusion into that estimate of property which is made by individuals.”

It is obvious that the error of this paragraph is exactly the opposite of the one in the preceding extract. And there is further, a much deeper error of principle. If the valuation of the merchant's estate be taken immediately after such a transaction with his banker, he is *creditor* of his banker in £19,000, and he is not *debtor* to his banker for the £20,000, but only collateral security in case the bills are not paid, leaving a balance of £1,000 against him, which is the sum he has to pay to his banker for the accommodation he receives. If Mr. Thornton's idea was true, that the banker and the merchant each valued their debts and credits as equal, it would mean that the banker discounted the merchant's bills for nothing, or issued his notes for the full amount of the bills, and it is only in such a case that their mutual debts and credits can be equal. But in fact, we see that the relations between the parties have been wholly misconceived.

9. But the fact is, that these paragraphs of Mr. Thornton's contain a much deeper error, and one which it is impossible that any one not acquainted with the laws and nature of Bills of Exchange should perceive. Mr. Thornton says, that “the banker who issues £20,000 in notes, and lends in consequence £20,000 to the merchants on the security of bills accepted by them, states himself in his books to be debtor to the various holders of his notes to the extent of the sum in question, and states himself to

be creditor of the acceptors of the bills in his possession to the same amount. His valuation therefore of his own property is the same as if neither the bills nor the bank notes had any existence." Passing over the extraordinary error of supposing that a banker issues notes to an equal amount to the bills he discounts, there is yet another error of a subtle nature which we must endeavour to point out. It is true, that a banker states himself to be debtor to the holders of his notes, but yet it is only a *contingent* liability, it does not become an actual debt until payment is *demand*ed for the note. While it remains in circulation it is exactly the same thing to the community as actual money, and the banker reaps the same profit from issuing it, as if it were actual money. And this is exactly in what banking consists; it consists in the creation of liabilities, in the multiplication of debts, which are to perform all the duties of actual money, and which so long as they do so, are in all respects equivalent to so much capital. Banking, therefore, consists in the multiplication of capital, that proposition so hard of digestion to our political economists. And just as many times as the quantity of liabilities he can maintain in circulation exceeds the quantity of bullion he keeps idle, just so much does his business consist in the extension of capital.

10. While, therefore, the notes of the banker, so long as they remain out, are exactly equivalent to so much capital, the bills of the merchants he holds are also saleable commodities, they do not go in cancelment and extinction of his notes, but are separate values, which he can dispose of and sell. They are pledges of the merchant's future industry, and have a separate value, just as the present value of every debt payable at some future time is a real, present, and actual value, over and above existing commodities. But we now come to the

next sentence. "Again, the merchants, in making their estimate of property, deduct the bills payable by themselves, which are in the drawer of the banker, and add to their estimate the notes of the banker which are in their own drawer, so that the valuation likewise of the capital of the merchants is the same as if the paper had no existence."

In this sentence we have now got thoroughly to the bottom of the whole fallacy. In the first place, we mark the astounding confusion in it, Mr Thornton says, the *acceptors* of the bills have the banker's notes in their drawers. What an extraordinary error! It is not the *acceptor* of a bill in commerce, who discounts it, but the *drawer* of it. The acceptor of the bill buys the commodities with the bill, and gives it to the vendor of the goods, it is the vendor of the goods who discounts the bill, and gets the notes. The acceptor of the bill, in process of time, *may* have some of the banker's notes in his possession, but there is no reason why he should. But now we come to the master fallacy of the whole subject. Merchants, in making an estimate of their property, do not *deduct* the bills payable by themselves. When a man has bought goods with a three months' bill, that bill is not a *diminution* of his actual property. The property is as much his own, as if he had paid for it with money. A trader who has accepted a bill, is not considered in law or custom to be in debt at all, until the day for payment of the bill comes. And the fallacy lies in this, that the bill is supposed to represent the goods; it does no such thing; it is not a lien upon the goods, but upon the trader's *industry*, and the goods are only collateral security in case his industry is unsuccessful. While therefore the bills are supposed to be good, they are a separate and additional value, over and above commodities.

11. Hence, we see that when a banker buys bills of ex-

change by creating liabilities, it is not a cancelment of debts, but the exchange of two separate values. It is exactly the same thing, as if one man asked another to give him change for a sovereign in silver. It is an exchange of values.

12. But some consider that a bill of exchange is not a separate value, because it is to be paid in money. Now, this argument is somewhat specious, but it is utterly unsound. If it were true that a bill has no value until it is paid, it would equally follow that money has no value until something is bought with it, and that money has no separate value from commodities. Money is only a species of a more general bill of exchange. A sovereign is only taken because it is a bill which every one will honor.

13. Now, the fallacy which is still so universally prevalent about bills of exchange, was equally prevalent during the last century, among many very eminent writers about money—namely, that money was only a sign of value. That is to say, that money only represented commodities because it was exchangeable for them. But one of the greatest services done by the political economists of the last century was to utterly overthrow this notion. Money is not a sign of value, or the representative of commodities, but it is a separate and independent value of itself. We have shewn that industry is the only method in which a man can earn property. A certain part of a man's industry he must have in commodities, such as necessities, but that part of it which he does not require immediately to expend in commodities, he may store up for future use, as it were, in money. Consequently the commodities a man has, are the fruits of one part of his industry, and the money he has, is the remainder. Hence, money and commodities are separate, distinct, and cumulative values. Hence, though a man takes money for his labor, because he knows he can exchange it for commodities, yet that money is not the *representative* of commodities, any more than if a shoemaker were to exchange some shoes for bread, with a

baker, would it be correct to say that the shoes were the representative of bread, and *vice versâ*. On the contrary they are *separate* values.

14. The extravagance and absurdity of the notion that money is a sign of commodities or values, is fully exhibited in Montesquieu, and we would venture to recommend an attentive study of what he says upon the subject, as it is necessary to understand the principles established by the writers of the last century, as the very foundation of Political Economy. Montesquieu says,* “Money is a sign which represents the value of all commodities.” “In the same manner that money is a sign of a thing, and represents it, everything is a sign of money, and represents it; and a state is in prosperity, whilst on one side the money fairly represents all the things in it, and on the other, all the things in it fairly represent the money, and they are signs of each other, that is to say, that in their relative values one might have one as soon as the other.” That is to say, Montesquieu gravely asserts that in a prosperous state, the money in it ought to be equivalent in value to all the other values in it. That the value of the money in it, ought to balance the value of everything else in it.

15. The incredible absurdity of this proposition leads to consequences which every reader of reflection can perceive. It was, however, the generally accepted notion at the time, and the labors of the first political economists, meaning thereby the first writers who are worthy of the name, were directed to overthrow it, and establish the proposition that money is merchandize in itself, it is a separate value, and not the *representative* of other values. And to master this truth is the first foundation of the science of money.

16. But the very same fallacies which were prevalent then upon the subject of money, are now prevalent upon the subject of credit, and indeed were propagated by the

* De l'Esprit des Loix. Book xxii. c. 2.

very writers who successfully established the true doctrines of the nature of money. By exactly the same process of reasoning which established that money is a separate and independent value over and above commodities, is it established that credit is a separate and independent value over and above money and commodities. Money is exchanged for commodities, but does not represent it, so also credit, or debts, are exchanged for money and commodities but do not *represent* them. There is no argument whatever which would appear to lead to the conclusion that credit is not a separate value, which cannot be shewn equally to prove that money is not a separate value. There is no argument which establishes the irrefragable truth that money is a separate value, that does not equally prove that credit is also a separate value, a value, however, which is liable to be destroyed.

17. The fallacy which pervades all modern writers on the subject is that unhappy one originated by Turgot, that credit is a *loan*. Credit is nothing of the kind. Credit is a *sale*, *i. e.*, two things are exchanged, and the property of each of them is interchanged; and the distinguishing feature of credit is that one of the articles of exchange is a debt, or a "promise to pay." The fallacy of the doctrine of credit above alluded to, is founded upon the fallacious views of the origin, or source of value. Value is supposed to spring from labor, and to be measured by the labor which produced it, whereas value is the exchangeable power of a quantity; and if any quantity whatever has exchangeable relations, that is, if it is capable of being bought and sold, it is a real value. Thus, if debts have exchangeable relations, that is, are capable of being bought and sold, they are real values.

18. It is supposed that because a bank note costs comparatively little to produce it, that it is of no value. But it is not the labor that it costs to produce it that gives it its value, but what it will exchange for. A bank note has value, not because it costs a few pence to produce it, but because the holder knows or believes that he

can at any time exchange it for five sovereigns, or for an equivalent value in commodities, that it has the same exchangeable qualities as five sovereigns.

19. It may be said that persons only sell their goods for a bill of exchange, because they know that on a certain day that bill will be redeemed. But why do they sell their goods for money? Because they know that they can purchase other goods with them whenever they please, and so redeem these bills, as it were. When a Scotch laborer works for hire for some time, he knows well enough that he will be paid in a £1 note. He takes that £1 note voluntarily in payment of his labor, and he buys food and clothes, and everything else with it just as readily as if it were a gold sovereign. It is considered in that country in all respects equivalent to a sovereign. Who in their senses can say that that £1 note has no *value*? But that £1 note is credit. Who in their senses can deny that it is capital? When a bank can create £1 notes which pass freely and voluntarily among the people, and perform exactly the same functions in society as gold sovereigns, who in their senses can deny that that bank creates a value? There are many parts of the country which might be improved by an outlay of capital. That is, if a person were to come with a thousand sovereigns, those sovereigns might be profitably expended in reclaiming the land. A Scotch bank seeing this, opens a branch there, and sends down a boxful of £1 notes, which are *credit*. Those £1 notes are expended in cultivating the land, and producing exactly the same effects as if they were sovereigns. Who in their senses can deny that they are CAPITAL? Who can deny that credit is capital in this case. And this is no uncommon case in Scotland.

20. It may be said, however, that these £1 notes have no value beyond the limits of Scotland, that they have no *intrinsic* value. But that is true of all values. All values, as we have already pointed out, are local. To say that a sovereign is a real value, and a £1 note is not, is

only true so far, that a sovereign is a value through a greater extent of country than a £1 note. But there are many countries where a sovereign would be of no use whatever, any more than a £1 note. Adam Smith says, that the revenue of a person to whom a guinea is paid does not properly consist in the piece of gold, as in what he can get for it, or in what he can exchange it for. *If it could be exchanged for nothing, it would, like a bill upon a bankrupt, be of no more value than the most useless piece of paper.* Which is unquestionably true. And the converse proportion is also equally true, that if a £1 note can be exchanged in any locality for exactly the same number of things that a sovereign can, the £1 note is, in that locality, of exactly equal value with the sovereign, so long as it is received as of equal value with the sovereign.

21. We must now examine what some modern writers have said upon the subject.—Mr. John Stuart Mill says:*

“The functions of credit have been a subject of much misunderstanding, and as much confusion of ideas, as any single topic in Political Economy. * * *

“As a specimen of the confused notions entertained respecting the nature of credit, we may advert to the exaggerated language so often used respecting its national importance. Credit has a great, but not, as many people seem to suppose, a magical power, *it cannot make something out of nothing.* How often is an *extension of credit* talked of as *equivalent to a creation of capital, or as if credit actually were capital.* It seems strange that there should be any need to point out that credit being only permission to use the capital of another person, the means of production cannot be increased by it but only transferred. If the borrower's means of production and of employing labor are increased by the credit given him, the lender's are as much diminished. The *same* sum cannot be used as capital both by the owner, and also by the person to whom it is lent.

“But though credit is *never* anything more than a *transfer of capital from hand to hand*, it is generally, and naturally, a transfer to hands more competent to employ the capital efficiently in pro-

* Principles of Political Economy, Vol. II. B. III. c. XI p. 36. 2nd Edit.

duction. * * * Although, therefore, the productive funds of the country are not increased by credit, they are called into a more complete state of productive activity. The principal instruments for this purpose are banks of deposit. Where these do not exist, a prudent person must keep a sufficient sum unemployed in his own possession, to meet every demand which he has even a slight reason for thinking himself liable to. When the practice, however, has grown up of keeping this reserve, not in his own custody, but with a banker, many small sums previously lying idle, become aggregated in the banker's hands; and the banker being taught by experience what proportion of the amount is likely to be wanted in a given time, and knowing that if one depositor happens to require more than the average, another will require less, is able to lend the remainder, that is, the far greater part, to producers and dealers, thereby adding the amount, not indeed to the capital in existence, but to that in employment, and making a corresponding addition to the aggregate production of the community."

22. And Mr. McCulloch says: *

"It is plain that to whatever extent the power of the borrower of a quantity of produce, or of a sum of money to extend his business, may be increased, that of the lender must be equally diminished. The same portion of capital cannot be employed by two individuals at the same time.

"When produce is sold in the way now described, it is usual for the buyers to give their bills to the sellers for the price, payable at the period when the credit is to expire; and it is in the effects consequent to the negotiation of such bills that much of that magical influence that has sometimes been ascribed to credit, is believed to consist. Suppose, to illustrate this, that a paper maker, A, sells to a printer, B, a quantity of paper, and that he gets his bill for the sum payable at twelve months after date, B could not have entered into the transaction had he been obliged to pay ready money; but A, notwithstanding he has occasion for the money, is enabled by the facility of negotiating or discounting bills, to give the requisite credit, without disabling himself from prosecuting his business. In a case like this, both parties are said to be supported by credit, and as cases of this sort are exceedingly common, it is contended that half the business of the country is carried on by its means. All, however, that such statements really amount to, is that a large portion of those engaged in industrious undertakings do

* Commercial Dictionary. Art. Credit, p. 467. Edit. 1854.

not employ their own capital, but that of others. In the case in question, the printer employs the capital of the paper maker, AND THE LATTER EMPLOYS THAT OF THE BANKER OR BROKER WHO DISCOUNTED THE BILL. This person had, most likely, the amount in spare cash lying beside him, which he might not well know what to make of; but the individual into whose hands it has now come, will immediately apply it to useful purposes, or to the purchase of the materials, or the payment of the wages of the workmen employed in his establishment. It is next to certain, therefore, that the transaction will have been advantageous, but still it is essential to bear in mind that it will have been so, not because credit is of itself a means of production, *or because it can give birth to capital not already in existence*, but because, through its agency, capital finds its way into these channels, in which it has the best chance of being profitably employed. The real advantage derived from the use of bills and Bank notes as money consists, as has been already shewn, in their *substituting so cheap a medium of exchange as paper, in the place of one so expensive as gold.* * * * * * On analysing any case of this kind we shall invariably find, that all that the highest degree of credit and confidence can do, is merely to *change the distribution* of capital—to transfer it from one class to another."

23. The examination of these extracts will show that they exhibit exactly the same inaccurate view of the subject of credit, that we have already seen in J. B. Say. But, in fact, to show Mr. Mill's error, we have only to call himself as a witness. Thus, while at p. 36, he ridicules those who think that credit is capital, and says that "credit is never anything more than a transfer of capital from hand to hand," and again, "the productive funds of the country are not increased by credit;" at p. 174 of the same volume, he says, "The value saved to the community by thus dispensing with metallic money is a clear gain to those who provide the substitute. They have the use of twenty millions of circulating medium, which have cost them only the expense of an engraver's plate. *If they employ this accession to their fortunes as productive capital, the produce of the country is increased, and the community benefited as much as by any other capital of equal amount.*" What need have we further to

point out the inaccuracy of Mr. Mill's views in the first paragraph, when he has so effectually done so himself in the second ?

24. Now, who can deny that the present value of a debt, payable at some future period, is a separate and independent value? It is a marketable commodity, it may be bought and sold like a pound of sugar, and the money that is paid for it does not *represent* it any more than the money *represents* any commodity that is exchanged for it. No one can tell where the money is that will ultimately discharge the debt, but even if they could the present debt is still an independent value to the money that will ultimately pay it. Because, both that debt and that money may pass through a hundred hands before the appointed day when they will be exchanged for each other. Now, what is a Bill of Exchange? It is nothing but a debt payable three months after date, say; and that debt has a present and separate value, quite independent of the money that will ultimately pay it. Now, when we affirm that credit is capital, we mean nothing more than this, that operations take place where one or both sides of the transaction are debts. That sales of goods and services occur, where a "promise to pay" forms one side of the transaction. A proposition, we presume, which no one in his senses will deny. We make no assertion involving the stupid blunder that the same thing can be in two places at once.

25. Now the question at issue is no trifling one. The property afloat in this country in bills of exchange, bank notes, and bank credits alone, is upwards of £600,000,000, and the question is, Whether this is a real and independent value, or only a myth? All Political Economists, from the days of Turgot, maintain that it is nothing, a mere nonentity, that it is of no more value than the paper it is written on. We, on the contrary, maintain in opposition to the entire body of writers in France and England, from Turgot to Mr. John S. Mill, that it is a real value, that is a separate and independent value over and above,

and perfectly distinct from money or commodities, and we have the most perfect conviction that we are right.

26. We have shewn clearly, what indeed no one who knows anything about the law or nature of bills of exchange will deny, that a bill does not represent property at all, but represents a debt, not even any particular sum of money. At the present moment in France, where a fever of speculation has been raging, the most dangerous notions upon the subject of credit are becoming prevalent, and are finding their way into books otherwise able and sensible. Thus, M. Joseph Garnier, in his work on Political Economy,* discusses three definitions of credit. The first is, that credit is the facility of borrowing, which is due to personal confidence, which he disapproves of. Secondly, that credit is an anticipation of the future, a definition which he still more disapproves of. Thirdly, that credit is the transformation of fixed and engaged capitals, into circulating or disengaged capitals. This definition he adopts from M. Cieszkowski, who has published a work, which seems to have attained some circulation on the continent, to develop this idea. The meaning of this is, that a bill of exchange represents some particular money, and that it, as well as Bank notes, &c., pass from hand to hand merely for greater convenience than the money. Their idea is that everything else may be mobilized in the same manner, land and all sorts of property. Thus, they confound bills of exchange with bills of lading, and dock warrants. Pamphlets are publishing with projects for founding Banks for the monetization of all values. It is too early here to expose the fallacy of these ideas, which are not new, and constituted John Law's system of money. That will be done in a future chapter.

27. We must now endeavour to trace the origin,

* *Eléments de l'Economie Politique.* p. 241. 3rd. Edit. 1856.

and ascertain the true meaning of the expression "circulating medium," and shew the changes of opinion that have taken place regarding it. The actual expression itself we have not been able to trace earlier than the last decade of the last century. It does not occur in Adam Smith. It does not occur in a pamphlet published in the year 1793, on the commercial crisis of that year, in which it would naturally have been employed, if it had been in common use. The first instance we have been able to discover of its having found its way into print, is in the year 1797, when we find Mr. Fox complaining that "circulating medium" was a novel term whose meaning was not very well settled. After that it becomes common enough.

28. In the first place we must observe that the verb to "circulate" has, like many other verbs in English, a double meaning. It has both an active and a neuter sense. Thus, I may circulate a report, and I may circulate myself, i. e., itinerate or travel about. So the verb "move" has similarly a double meaning, I may move another thing, and I may move myself. Now, money both may circulate itself and it may circulate other things. Adam Smith, with that unfortunate want of precision which forms so great a drawback to the merits of his work, constantly uses it in both senses, in different places; nay, even uses it in both senses in the same sentence. Thus, he says of money:* "The great wheel of circulation is altogether different from the goods which are circulated by means of it. The revenue of the society consists altogether in those goods, and not in the wheel which circulates them." A little further on, he speaks of the different sorts of paper money, but he says the *circulating* notes of banks and bankers, are the species which is best known. In these two sentences the word *circulate* is used in two different

* Wealth of Nations. On Metallic and Paper Currency. B. II. C. 2.

senses. In another place he says, "The only use of money is to circulate goods." In the following sentence both senses occur. "Let us suppose, for example, that the whole *circulating* money of some particular country, amounted at a particular time to one million sterling, that sum being then sufficient for *circulating* the whole annual produce of their land and labor." And so in this sentence, "When we compute the quantity of industry which the *circulating* capital of any society can employ, we must always have regard to those parts of it only which consist in provisions, materials, and finished work; the other, which consists in money and which serves only to *circulate* those three, must always be deducted." "What is the proportion which the *circulating* money of any country bears to the whole value of the annual produce *circulated* by means of it, it is perhaps impossible to determine." Hence, we observe that the word to "circulate" was used in both senses by Adam Smith, though he does not use the expression circulating medium.

29. In the pamphlet of 1793, though we do not find the words in actual conjunction so as to form one expression, we yet have the idea. Thus, the writer speaking of the enormous trade of Great Britain says, "The *medium* by which this extensive trade has been conducted is paper credit; a medium which alone is equal to the emergencies of so quick and so remote an intercourse." In a subsequent sentence he says, "The enormous but unsubstantial capital by which the productions of the world were so expeditiously *transferred* from region to region sinks in a moment to a few hard guineas." Now, it is quite evident that the expression "*circulating medium*" is merely the essence of these two sentences.

30. But the ordinary meaning of words in scientific language leaves no possible doubt as to which of the two senses of "circulate" is the true

one in the expression "circulating medium." A *medium* in scientific language invariably means some middle thing, by or through which something else is done. Thus, we speak of a medium of communication, being some one, or some thing, through whom or through which, something is communicated from some one to some one else. So a circulating medium must mean a medium of circulation, through or by means of which something else is circulated. If we are to interpret the word circulating as that which circulates itself, we may substitute some other words of equivalent meaning in the expression, and it comes to this that the circulating medium means the "travelling middle," which reduces the expression to absolute nonsense.

31. In a philosophical sense, then, it is perfectly certain that the expression "circulating medium" does not mean the itinerating medium, or the medium which necessarily circulates itself, but the medium that circulates commodities. And this was beyond all doubt the meaning attributed to it, at the time it originated. We have observed that Mr. Fox, in 1797, complained that the expression was a novelty, whose meaning was not very well settled. At the same time Mr Pitt said that, "As so much has been said on the matter of a circulating medium, he thought it necessary to notice, that he did not for his own part take it to be of that empirical kind, which had been generally described. It appeared to him to consist in anything that answered the great purposes of trade and commerce, whether in specie, paper, or any other terms that might be used."* Mr. Walter Boyd, an eminent merchant, says, "By the words 'means of circulation,' 'circulating medium,' and 'currency,' which are used almost as synonymous terms in this letter, I understand always ready money, whether consisting of bank notes or specie, in contradiction to bills of exchange, navy bills, exchequer bills, or any other negotiable

* Parl. Hist. Vol. xxxiii. p. 342.

paper which form no part of the circulating medium, as I have always understood that term. The latter is the *circulator*, the former are merely *objects of circulation*.”* Thus, we see that, though Mr. Boyd excludes bills of exchange from the term circulating medium, he expressly says that it means the *circulator*, or that which circulates something else. Somewhat later than this we have Mr. Ricardo, who commences his pamphlet on the high price of bullion thus: “The precious metals employed for *circulating* the commodities of the world,” &c. And in the next page he says, “The smaller quantity of money would perform the functions of a *circulating medium* as well as the larger.” And we may quote Lord Liverpool in 1819, when speaking on the currency bill of that year. He was speaking of the circulating medium of Lancashire being composed of bills of exchange, and he says, “That the human ingenuity which had been so successful in discovering other mechanical contrivances, had not been less so in devising means for circulating the property of the country in the most expeditious and profitable manner.” We might multiply authorities, but it is needless to do so; but having settled in this way that the meaning of circulating medium is the medium which circulates commodities, we have next to inquire what things are included in it. We have seen that Mr. Pitt includes all forms of credit. Mr. Boyd excludes bills, but the slightest consideration will shew that Mr. Boyd’s own definition condemns his own opinion. Mr. Thornton says† immediately afterwards, speaking of bills of exchange, “They evidently form in the strictest sense, a part of the circulating medium of the country.” And in a note on this passage censures Mr. Boyd for propagating the same error into which many others had fallen, of considering bills as

* Letter to the Right Honorable Wm. Pitt on the Influence of the Stoppage of Issues in Specie at the Bank of England on Prices; by Walter Boyd, Esq., M.P. p. 2. note. 1801.

† Essay upon the Nature and Effects of Paper Credit. p. 40. 1802.

no part of the circulating medium. In 1819, Lord Liverpool as we have seen, expressly called the bills of exchange by which the business of Lancashire was carried on, circulating medium. In 1823, in the debate on Mr. Western's attack on the currency act of 1819, the Marquis of Titchfield said, "When it was considered to how great an extent these contrivances, *i.e.*, for economising money, had been practised in the various modes of verbal, book, and circulating credits, it was easy to see that the country had received a great addition to its currency. This addition to the currency would of course have the same effect as if gold had been increased from the mines." And up to the Bank Charter Committee of 1832, we have no hesitation in saying that the immense preponderance of opinion held that bills of exchange formed part of the circulating medium, for this very plain reason, that they cause commodities to circulate.

32. In the committee of 1832, several of the witnesses adopted the opposite view, and maintained that bills of exchange were not circulating medium, or currency, these expressions being used as identical. And this opinion appeared with greater force still in the Bank Charter Committee of 1840, and we must examine into the reasons alleged by them in support of that opinion. Thus, Mr. Cobden* said that there was a great distinction between a bill of exchange and a bank note payable on demand, as the former bears interest until it is due, as no one would take it with three months to run, without being allowed discount upon it; and as the longer it is kept the more interest it bears, there is not the same motive for putting it into circulation as there is a note. He also said that a bill follows the trading transaction, and is merely a voucher for it in the shape of a transfer of the debt.

33. Mr. J. B. Smith, President of the Manchester

* Report of Committee on Banks of Issue. 1840. Evidence—Questions 559—578.

Chamber of Commerce,* considered bills not to be currency, but only a debt; that the difference between a bill and currency is, that the latter would discharge a debt, but the former would not; that the passing of a bill is a mere transfer of debt, but a payment in currency is a discharge of a debt. But country bank notes were currency.

34. Mr. W. R. Wood† considered the metallic money and bank notes of all sorts currency, but excluded bills of exchange from that name; although he admitted that they frequently performed the functions of currency in making payments, yet they always did so with certain marked distinctions, inasmuch as, to pay a debt with a bill must always be a matter of bargain, that such payment does not release from liability, and that a party receiving payment of a debt would always prefer receiving it in bank notes to receiving it in a bill.

35. Mr. G. W. Norman‡ did not consider bills of exchange as currency, but as banking expedients to economise currency, and they do not possess fully the qualities which he considered money to possess. He said that the three most essential qualities which money should possess, are, that it should be in universal demand by everybody, in all times and in all places, that it should possess a fixed value, and that it should be a perfect numerator. Now, banking expedients of all sorts do not possess these qualities fully, but only in a very low degree. A bill of exchange was of no use to a man unless it was indorsed to him; he cannot go into a shop with one and buy what he wants, nor can he pay his laborers with a bill of exchange. So with bankers' deposits; he cannot do with them whatever he can do with sovereigns and shillings.

36. Mr. S. J. Lloyd expressed exactly the same opinion as Mr. Norman.§ He said:—

* Report of Committee on Banks of Issue, 1840. Evidence—Questions, 70—99.

† Ibid. 591.

‡ Ibid. 1694-6.

§ Ibid. 2663—4.

"The precious metals, converted into coin, constitute the money of each country. That coin circulates sometimes in kind; but in highly advanced countries it is represented, to a certain extent, by paper notes, promising to pay the coin to bearer on demand, these notes being of such a nature in principle, that the increase of them supplants coin to an equal amount.* When these notes are in use, the metallic coin, together with these notes, constitutes the money, or currency of that country. Now, this money is marked by certain distinguishing characteristics; first of all, that its amount is determined by the laws which apportion the precious metals to the different countries of the world; secondly, that it is in every country the common measure of the value of all other commodities, the standard by reference to which the value of every other commodity is ascertained, and every contract fulfilled; and thirdly, it becomes the common medium of exchange for the adjustment of all transactions *equally at all times, between all persons, and in all places*. It has, further, the quality of discharging those functions in endless succession. Now, I conceive that neither deposits nor bills of exchange in any way whatever possess these qualities. In the first place, the amount of them is not determined by the laws which determine the amount of the precious metals in each country. In the second place, they will in no respect serve as a common measure of value, or a standard by reference to which we can measure the relative values of all other things; and, in the next place, they do not possess that power of universal exchangeability which belongs to the money of the country."

37. The above witnesses all used the words "currency" and "circulating medium" as synonymous; and we may now make a few observations upon their opinions which will not detain us long. Mr. Cobden's distinction, that a bill of exchange is only of use for the transfer of a debt, is answered at once, because that is the *very definition* we have endeavoured to establish of a currency.

38. Mr. Smith's and Mr. Ward's opinion that passing a bill was a mere transfer of debt, that paying in currency was a discharge of it, and that a payment by bill must always be a matter of bargain, and that such payment did not release from liability, are objections that are

* We have already shewn the error of asserting that bank notes only displace an *equal* amount of coin; on the contrary, they are capable of being beneficially employed where coin never existed.

equally applicable to bank notes. Payment by country bank notes is always a matter of bargain. No man can be compelled to receive country bank notes in payment of a debt, any more than a bill of exchange. Bills and notes payable to bearer on demand, *i. e.*, cheques and bank notes, are intended by law to be presented *immediately* for payment, either on the day of receipt, or at least on the day after, precisely as a bill of exchange is intended to be presented for payment on a fixed day. In both cases, if the receiver of the bill or note, has it indorsed and presents it in proper time, the indorser is liable, in both cases, if he fails to do so the indorser is discharged. There is not a shade of difference in *principle* between the two cases, only that one is payable immediately, and the other on a future day. Notes which are issued by bankers generally enjoy better credit, and are more willingly received, in some cases, than bills; but it is to the last degree unphilosophical and incorrect, to consider them of a different *nature*, because one is of a somewhat more eligible *degree* than the other. It would be just as correct to say, that iron heated to the temperature of 100°, was of a different *nature* to iron heated to 200°. One species of currency has a greater degree of eligibility for circulation than another, but still it is currency. Coal and wood in the furnace of a steam engine have different degrees of evaporating power, but still they are both *fuel*.

39. It is not a little amusing to find the celebrated phrase of the Roman Catholic Church,—*Quod semper, quod ubique, quod ab omnibus*, starting up and meeting us in a discussion on currency. In Mr. Lloyd's opinion, money and currency are identical, and include the coined metallic money, and the paper notes promising to pay the bearer coin on demand; and he says that the characteristic of their being money, is, that they are received equally at "*all times, between all persons, and in all places.*" In order to avoid prolixity, let us denote this phrase by the symbol A³ (from the three alls in it). He excludes bills of exchange from the designation of currency, because

“they do not possess that power of universal exchangeability which belongs to the money of the country.” It is impossible to imagine a definition which could be more suicidal to Mr. Lloyd's view than the one he has chosen. In fact, if it be true, there is *no such thing as money or currency at all*. In the first place it excludes the whole of the issues of bank notes at one fell swoop. The notes of a Bank in the remote district of Cumberland would not be current in Cornwall, *therefore* they are not A³, *therefore* they are not currency. Again, the notes of a bank in Cornwall would not be current in Cumberland, *therefore* they are not currency. Similarly, we may almost say that there are no country bank notes at all which have a general currency throughout England, therefore no country bank notes are A³; *therefore* no country bank notes are currency. Till within the last thirty years, the notes of the Bank of England had scarcely any currency beyond London and Lancashire; in country districts a preference was universally given to local notes, therefore Bank of England notes were not A³, they had not a power of “universal exchangeability;” *therefore* they were not currency. If, therefore, the test of A³ and “universal exchangeability” be applied, the claims of all bank notes to be considered as currency, are annihilated at once. The acceptance of a Baring or a Rothschild would be received in payment of a debt by a far larger circle of persons than the notes of an obscure and remote country bank. But Mr. Lloyd further excludes bills from the term “currency,” because their amount is not determined by the laws which determine the amount of the precious metals in each country. But is the amount of bank notes determined by these laws? He says that the increase of bank notes only supplants coin to an *equal* amount; but this is a most extraordinary assertion for a banker to make. Where the issue of them is free, it is absolutely certain that their amount will greatly exceed the amount of gold and silver coin that ever would have existed.

40. But the universality of Mr. Lloyd's assertion is fatal to his argument in other ways. On the Continent silver is the legal standard of value, in Great Britain silver, like copper, is merely coined into small tokens, called shillings, &c., which are made to pass current above their intrinsic value, and are only legal tender for a very trifling amount, hence it cannot be used in the adjustment of *all* transactions, *therefore* it is not A³, *therefore* it is not currency. There are other countries where gold is not a legal tender, therefore it fails to satisfy Mr. Lloyd's test, therefore it is not currency. If then, the test proposed by Mr. Lloyd be considered as correct, it is easy to see that there is no substance or material whatever that will not fail under it, and, therefore, *there is no such thing as currency.*

41. The fact is, that the only difference between a bill of exchange and a bank note, is, that the former is a promise of a deferred payment, and the latter that of an immediate one; and there is less risk in taking the latter than the former. From these circumstances a bank note possesses a greater *degree* of circulating power than a bill of exchange. But in the midland counties of England, it used to be quite common for the banks to issue the bills of exchange they had discounted, with their own indorsement upon them. In which respect they were in every respect equivalent to bank notes; moreover, there is not the same inducement to put a bill into circulation as a bank note, because the former increases in value as the day of payment approaches. But it is unprofitable to keep a note idle. But it is to the last degree unphilosophical to maintain that these two obligations are of different *natures* because they are adapted to circulate in different *degrees.*

42. The views of those who hold this opinion, cannot be better represented than by Colonel Torrens, who says,* "The terms, money and currency, have hitherto

* The Principles and Practical Operation of Sir Robert Peel's Act of 1844, explained and defended, p. 79.

been employed to denote those instruments of exchange, which possess intrinsic or derivative value, and by which, from *law or custom*, debts are discharged, and transactions finally closed. Bank notes payable in specie on demand, have been included under these terms as well as coin, because by law and custom the acceptance of the notes of a solvent bank, no less than the acceptance of coin, liquidates debts and closes transactions; while bills of exchange, bank credits, cheques, and other instruments by which the use of money is economized, have not been included under the terms of money and currency, because the acceptance of such instruments does not liquidate debts, and finally close transactions."

43. It is upon these views that the opinions of all the persons rest, who hold the doctrine that bills of exchange are not currency or circulating medium, to which the reply is short and simple, that even if the allegations were true they are nothing to the purpose, because they only go to shew that there are different species of currency or circulating medium, some of more eligible descriptions than others. But the allegations contained in the preceding paragraph are not true. In laying down legal doctrines, Colonel Torrens has ventured beyond his depth, and the above statements would excite the surprise and ridicule of the pupil room of every special pleader in the Temple. We have already exposed their fallacy and absurdity, which we need not here repeat. Nevertheless, these were the doctrines adopted by Sir Robert Peel in the third state of his opinions, in which he carried his Banking Act of 1844. which we shall more fully inquire into hereafter.

44. In order, if possible to strengthen our position, we may adduce the testimony of one of the most celebrated living Political Economists, who has expressly repudiated the doctrines adopted by Sir Robert Peel, and adopted them for the same reasons. Thus, we have seen that Michel Chevalier has a separate chapter on the subject and criticizes and condemns the views of Torrens, &c.

almost the very same terms that we have done. And not only does he condemn these doctrines, but he has determined to adopt an extension of the French word *numeraire* to coincide with *currency*. He concludes the chapter thus,* “The English language has a generic word which includes money, bank notes, inconvertible paper money or assignats, and every other species of denomination which can be put into circulation, and which men more or less generally accept; and that is the word *currency*. Our language has no exact equivalent. Nevertheless the term *numeraire* may be taken in the same sense, and I shall use it so in the remainder of this work.” Surely the opinion of so distinguished a writer as M. Chevalier will have some weight.

45. We will give a very analogous case to the meaning which we have established as the true one for the expression “circulating medium,” when applied to *currency*. A newspaper is also called a circulating medium. Of what is it the circulating medium? Of intelligence. And it is not called the circulating medium of news because it circulates itself, but because it *circulates news*. In the indictment against Joseph Gerrald,† in one of the famous trials for sedition, in 1794, he is charged with making seditious speeches, the substance of which was “published in a newspaper, published at Edinburgh, entitled the ‘Edinburgh Gazette,’ and through that *medium circulated* among the lieges.” Here we have the exact analogy; What was the circulating medium? The newspaper. Why was it called so? Because it was the medium through which the seditious matter was circulated among the lieges. Was it called so because it circulated itself? Certainly not, because if the newspaper had been posted up on a wall, and been read by people standing still, it would still have circulated the intelligence, without circulating itself. How it circulated the

* Cours d'Economie Politique. Vol. III. La Monnaie, p. 39-47.

† Howell's State Trials. Vol. XXIII. p. 815.

news was, therefore, a matter of secondary consideration, though it often happens that newspapers do circulate themselves as well. It is exactly the same with the circulating medium of commodities. How it performs its duty is a matter of secondary consideration. Hence, book credits are equally circulating medium with money, though after the debt has once moved from the purchaser to the vendor, they do not themselves circulate further.

46. Moreover, the *law of continuity* or the *method of gradation* comes into play with decisive effect to prove the entire fallacy of Lord Overstone's doctrine upon the subject. He maintains that only promissory notes payable *on demand* are currency. But would not notes payable one minute after demand be currency? or one hour? or two, or three, or four hours? Would not notes payable one day after demand be currency? or two, or three days? Are not Bank post bills, which are payable seven days after sight, currency? Where is it possible to draw the line? But the same arguments apply to one month, or two, or three months or any longer period*. The answer to any one who is acquainted with the invariable course of reasoning in Natural Philosophy is simple and conclusive. They are all species of currency, though differing in degree, and the distinction between them is untenable.

47. But while we contend that Mr. Lloyd's criterion of a currency is fatal to his own view, we are quite willing to accept it. For what is it that exists in all places, in all times, and among almost all persons? DEBT, or SERVICES DUE.—And what is it that is universally required to measure, record, and transfer them? *Some material*. But we see that all currencies are more or less local, none are universal. The idea, or the want, alone is universal. The notes of a country banker, only circulating in his own neighbourhood, are like a country *patois*, each dis-

* The reader will also think of Horace. Epis. ii. i. 40.

trict has its own. A national currency rises to the dignity of a language. But even that is only local, on a larger scale. The ideas only expressed in the language are universal. We are, therefore, strengthened in our conviction that the only true idea of a currency is, that it is the REPRESENTATIVE OF TRANSFERABLE DEBT ; and that **WHATEVER REPRESENTS TRANSFERABLE DEBT IS CURRENCY.**

CHAPTER IV.

THEORY OF THE EXCHANGES.



CHAPTER IV.

ON THE THEORY OF THE EXCHANGES.

NECESSITY FOR MONEY CHANGERS—DIFFERENCE BETWEEN MONEY CHANGING AND BANKING—FOREIGN EXCHANGES—DETERIORATION OF THE CURRENCY CAUSES A FALL IN THE FOREIGN EXCHANGES—THE MINT AND MARKET PRICE OF GOLD BULLION—DESCRIPTION OF THE COMMERCIAL OPERATIONS OUT OF WHICH THE EXCHANGES ORIGINATE.

1. Next to a universal language, it would be the greatest commercial blessing to all nations, if they could agree to use one uniform measure of value, and the same weights and coins. No small part, nay, we might almost say the chief part, of the intricacy and subtlety of the subject of exchanges, arises from different nations using different metals as the legal measure of value, and coins of all different denominations and values. If all nations could be brought to a uniformity on these subjects, there would be no more difficulty in understanding the theory of the exchanges between them than of those between England and Scotland. The artificial intricacy of the subject of exchanges gives rise to the employment of a considerable amount of labor, which is unprofitable to the community at large, exactly in the same way as a superfluous amount of technicality in a system of law gives rise to a large amount of unnecessary law business. Every one who has travelled abroad knows how detrimental the different exchanges are to his purse, as he passes

through the different states. If any one were to take a quantity of money with him abroad, and pass through several different states, like those in Germany, it would soon dwindle away to almost nothing by the repeated operation of exchanging it for the current money of the country he happened to be in at the moment. The profits of the money-changers, as they do not arise out of natural operations, but out of the artificial distinctions in the different coinages, are wholly unprofitable to the community at large, because in this case it is true, what many people think of real commerce, that the gains of one party are wholly made up of the losses of a number of others,* whereas the test of genuine commerce is that both parties gain by the very nature of the transaction. It is clear that the gains of the money-changers are no more additions to the wealth of the community, than the practice of sweating sovereigns in a bag, where the apparent profit is made up of the losses on each coin.

2. Banking first grew out of the operations of the money changers, and was first practised by them, but yet banking and money-changing are wholly different in their nature. The latter produces no benefit to society, the necessity for it only arises out of the artificial and unnecessary defects of the commercial regulations of nations. If these were put on a better footing, the whole trade of money-changing would be swept away at a breath. As the want of proper sanitary arrangements often breeds the diseases which cause the necessity for medical men, so it is the imperfection of the monetary systems of the world that produces the necessity for money-changers. Banking on the contrary is wholly different in its nature; it is genuine commerce, and like all genuine commerce it promotes the interests of both parties, it blesses him that lends, and him that borrows, and augments the prosperity and wealth of the community at large. The correction

* Montaigne has, we believe, the unenviable distinction of originating this sentiment, the fruitful parent of innumerable wars for several centuries.

of the imperfect system which gives rise to the necessity of money-changers, would be an unmitigated blessing to every nation in the world; the abolition of banking would be the direst blow commerce could receive.

3 So long, however, as this imperfection in the monetary system exists, and nations continue to act against their own interests, the business of money-changing is rendered necessary, and the theory of the exchanges requires to be studied as an essential branch of Political Economy.

4. When nations advanced beyond the stage of direct barter, and began to use the precious metals as a common measure to which the value of all other commodities was referred, it was the *weight* of the pure metal which was universally used as the index of value, and merchants carried scales about with them, for the purpose of weighing out the metal on each separate occasion. To make the transaction complete they should also have assayed the metal on each purchase, because fraudulent dealers might adulterate it. However, assuming that the bullion was always of proper fineness, values were estimated by the weight of the metal. However, the necessity of carrying about scales to weigh out the metal on each separate occasion being felt to be tedious and irksome, the plan was devised of cutting the bullion into pieces of a certain definite weight by the public authority, and putting a stamp upon them to certify to the community that they were warranted to contain a certain weight of bullion of a certain definite fineness. Values were then estimated by the number of these pieces of bullion, which were called coins, which were given for commodities, and then they were said to be reckoned by *tale*. It is clear that the sole object of coining was to save the trouble of weighing, and that, though the prices of articles were estimated in figures, it was essentially part of the understanding that these figures denote certain specific quantities of pure metal.

5. We must beg our readers to brand this principle

on their memories, that although the stamp gave the coin currency, it was the weight of bullion alone in it which gave it value, and which measured its value, *i.e.*, the quantity of services it could command at any given place and time. This is the fundamental principle of the subject, which will enable the reader to steer his course safely through all the shoals and quicksands of monetary controversies. It might almost excite a smile that we so earnestly impress this. But an error on this point is at the root of all the extravagancies on the subject, which have so long vexed the public ear. They almost all arise from confounding the name, or denomination, of a coin, with its value; its name with its purchasing power: and supposing that if the legislature chose to call a *shilling* a *pound*, that therefore a shilling would have the value of a pound.

6. So long as these coins circulated in the country in which they were issued, they might diminish considerably in weight, without losing their value. People are so accustomed to attach a certain value to the sight of a particular coin, that (unless they be money dealers) they will not stop to inquire too curiously whether it is exactly of the proper weight or not; and, in fact, when a coinage has been long in use, few people know what the legal weights of the different coins are, many do not associate the idea of a pound, for instance, with any particular weight of bullion, still less have they usually the means of detecting whether it is of the proper purity, and if every one be willing to receive it, and give his commodities or services for it at its nominal value, it makes little difference what its weight is. Shakespeare is an authority even on the currency;*

“Twene man and man they weigh not every stamp,
Though light, take pieces for the figure's sake.”

When coin has been some time in circulation its true value must necessarily fall below its nominal value, from

* Cymbeline. Act. V. Sc. 1v.

the wear and tear of circulation, even if it be not subjected to any bad practices, such as clipping or sweating, and in states which cannot afford a frequent recoinage, this deterioration often proceeds to great lengths. In many instances in this country, and so late as 1816, when the last great reformation of the coinage took place, a large portion of the circulating medium was nothing but a thin wafer of silver, from which all traces of an impression had long since vanished, and reduced to scarcely more than half its proper and legal weight; and the same is the case with some of the continental states at this day, especially in Italy.

7. When these coins, however, are carried to a foreign country, they are of no value beyond their intrinsic weight as bullion. Though the natives of the country it belonged to, from long habit and association of ideas, see in it a certain denomination, and may receive it at its nominal value long after it has lost its legal weight, a foreigner sees in it nothing but so much bullion. When a person takes the coin of one country and purchases the coin of that country with it, he is said to *exchange* it. Now, suppose that the coinage of two countries is of the same metal, and that both of the coinages be of their full legal weight and fineness; then if either of them be taken as a standard, which may be called A, then the number of units, or parts of a unit, of the coinage of the other, which may be called B, which contains precisely the same quantity of pure bullion, is called the **PAR OF EXCHANGE** between the country A and the country B. Thus, if the legal standard of France and England were gold, and the pound be taken as the standard unit of England, the number of the standard units of the French coinage which contained precisely as much pure gold as the English pound, would be the par of exchange between England and France. The French standard is the franc, which is a silver coin. The gold Napoleon is also legal tender, which is twenty francs. Now, there is as nearly as possible one-fourth more pure gold in a sovereign than in a

Napoleon, therefore, as the par of exchange is the ratio between these two coins, we might say that 1.25 is the par of exchange between England and France. But as it is invariably expressed in *francs*, 1.25 Napoleons is equivalent to 25 francs, and hence we may, for the sake of argument, call 25 the par of exchange. Hence, if an English sovereign would exchange for 25 francs in Paris, we should say that the exchange was at par.

8. Though a worn and depreciated coinage might pass for its full nominal value in its own country, in a foreign country it will evidently only exchange for its actual weight in bullion; hence, if the English coinage of sovereigns became worn and clipped, or much diminished in weight, they would not exchange for so many francs as they would do if they were of full weight; hence, an English sovereign, if taken to Paris whilst the French coinage maintained its full weight, in such a depreciated state, might only exchange for 22 or 20 francs, and this would be called a *fall in the foreign exchanges*; or if an English merchant were bound to pay his creditor in Paris 2,500 francs, he would have to give more than £100 English to purchase them, and the exchange would be said to be so much *per cent. against England*, by the amount of that difference.

9. It is evident that this adverse state of the exchange would continue so long as the English coinage remained depreciated; but that if it were restored to its legal standard, that restoration would be itself sufficient to restore the exchange to its usual rate. Hence, we see that if any foreign country maintain its coinage of full weight and purity, that a *depreciation of the coinage of England necessarily produces an apparently adverse state of the exchanges, and that a reform of the English coinage is sufficient by itself to restore them to their proper state.*

10. It is also evident that a depreciation of the coinage by a debasement of its purity, will produce exactly the same effects. It is also clear that if the coinages of both countries were equally degraded, the rate of exchange

would not be altered between them; and that the rate would vary just in proportion as one was more or less degraded than the other.

11. It is also evident that there can be no true par of exchange between two countries which do not employ the same metal as their legal standard. We have seen in a former chapter the insuperable objections to employing two metals as legal standards in the same country. Up to a comparatively recent period gold and silver were equally used, and their relative values were fixed by law. This was their legal par of exchange, but we also saw that their market values were constantly varying, and from causes quite beyond the reach of any law, and that it was no more possible to have a fixed price of one in terms of the other, than to have a fixed legal price for corn or any other commodity. The very same rule must clearly apply to two countries, one of which uses gold and the other silver as their measure of value. Hence, in speaking of the par of exchange between England and France as 25·20, which it usually is, or that £100=2,520 francs, it is only on the assumption that the relative values of gold and silver are fixed, which we know can never occur between any two countries, any more than between the same metals in the same country. The only correct mode of expressing it is therefore to say that such is the *usual rate of exchange* between the two countries.

12. In the year 1797, when the Bank of England stopped payment, the House of Lords appointed a committee to investigate the whole subject. The committee, among other things, wished to ascertain the par of exchange between London and Hamburgh, and they examined several merchants upon the subject, but they were quite unable to agree among themselves what was the par of exchange between these two places; and the committee reported that they were unable to come to any satisfactory conclusion on the subject, and in this they were correct. And the very same reasons apply to any other two countries which use different metals as measures

of value, as there is not in the nature of things any permanently fixed relation between them. Hence, there cannot be in the nature of things any fixed par of exchange between England and any country that uses exclusively a silver standard. The most that can be said is, that there is a usual rate of exchange between them; hence, between such countries it is often totally impossible to decide certainly which way the exchange is, unless the difference exceeds a certain limit. At the time of the foundation of the Bank of England, in 1694, the coinage of England was in such a disgraceful state from the wear and tear of many years, and extensive clipping, that the rate of exchange between London and Hamburgh, owing to this circumstance alone, was 25 per cent. against England.

13. If the coinage of a country fall into a degraded state from long wear and tear, and a new coinage of full weight be issued, and allowed to circulate along with it, one of two effects must inevitably follow: either those persons who have commodities to sell will make a difference in the nominal price of articles, according as they are paid in the full-weighted, or the degraded coin, that is, the degraded coin will be at a discount as compared with the heavy coin; or, if there be a law to prevent this, and to make both pass at the same value, the bullion dealers will immediately collect all the full-weighted coins they can and melt them down into bullion; so that the new coinage will quickly disappear from circulation.

14. If persons in selling their goods made a difference in the nominal prices of them, according as they were paid in light or heavy coin, so as to secure a certain weight of bullion in exchange for their goods, they would of course require a larger number of the light pieces than of the heavy ones, and so prices would apparently rise if paid in light gold. This would be precisely analogous to a rise in the rate of exchange against England, caused by the depreciation of the coinage.

15. In such a state of things the prices of goods are evidently fictitious—a number of light pieces are presumed to have the same value as the same number of heavy pieces. Merchants raise the prices of their goods to secure to themselves a certain weight of bullion, and that weight of bullion is expressed in a greater number of figures than it ought legally to be; and yet, supposing no discount is made for heavy pieces, the same number of heavy pieces will purchase no more. This is as great an anomaly in commerce as it would be in arithmetic to say that three were equal to four. But the consequence is very plain. If four pieces of coin will only purchase as many commodities as three ought to do, no one will turn bullion into coin at so great a disadvantage. On the contrary, as bullion would diminish so much in value, it would be sent to other countries, where it would purchase a greater amount of commodities. Hence, the infallible effects of a fall of the foreign exchanges, caused by the depreciation of the currency, is not only to prevent bullion being imported into it, but to drive out what bullion there is already in it to foreign countries.

16. We may take an example. Let us suppose that the coinages of England and France were so related that twenty pieces of French coin contained precisely the same amount of pure gold as sixteen pieces of English coin. Now, suppose that while the French coin maintained its standard, the English coin became so degraded that twenty pieces of it only contained as much gold as sixteen ought to do; then the exchange would rise 25 per cent. against England. Now, if traders in England were prohibited by law from making a difference in the prices in their goods, according as they were paid in light or heavy coins, it is clear that no one would bring bullion from France to England when it would cost them twenty pieces to buy the goods they ought to get for sixteen. No one would bring his commodities to a market where they were artificially depressed below their proper value, any more than he would willingly purchase a loaf of

bread of short weight. So such a state of things would effectually preclude any bullion from being brought into the English market, and would, besides that, cause any bullion that was already in the country to be exported.

17. A general depreciation of the coinage therefore infallibly causes a fall in the foreign exchanges, or, in other words, causes the English coinage to fall to a discount: and this can be removed only by a sedulous attention to preserve the coinage at its full weight, and to cause all coins which are not of full weight to be withdrawn from circulation. Or, if not, instead of forcibly compelling people to receive light coins at the same value as heavy ones, they ought to be encouraged to make a difference between them, so as to remove the temptation to tamper with the good coinage.

18. Precisely analogous to a rise of the foreign exchanges adverse to England, caused by the depreciation of the coinage, is a difference between the mint price and the market price of gold. The term "mint price" has somewhat changed its meaning since it first came into use, a circumstance which has escaped the attention of many writers, and, as it is not unusual to see many mistaken notions of it in print, it will be no loss of time to dwell upon it somewhat minutely.

19. The word "price," except in the single instance we are now considering, is invariable used to denote the quantity of one article used as a standard which is given for another article of a *different* nature; thus, we say that the price of a bushel of corn is six shillings, where the silver, the substance of which the shillings are composed, is of a different nature to the corn. During the period when gold and silver were equally legal tenders, we have seen that their relative values were fixed by law, and a guinea was supposed to be equal to twenty-one shillings in silver, at its market value; and if the bank wished to purchase gold with silver, they would have to pay twenty-one shillings in silver for every

quantity of gold equal to a guinea ; and if this could always be done, twenty-one shillings would always be the market price of a guinea's weight of gold. Measured by the relative values of the metals at the time the standard was fixed in 1717, an ounce of gold was held to be worth 77s. 10½d. in silver, and accordingly as every twenty shillings was called a pound, £3 17s. 10½d. was the market price of gold per ounce at that time. During the course of the last century the relative values of gold and silver did not vary very materially till the year 1794, when gold became so much scarcer than usual, in comparison with silver, that the market value of the two became seriously different from the mint value, and the price of gold rose to eighty-four shillings in silver, that is, the bank could not purchase an ounce of gold with a less amount of silver than could be coined into eighty-four shillings. While, therefore, gold bullion was purchased with silver, the words market price and mint price bore their usual meaning of purchasing one commodity with another, and the attempt to *fix* the market price of gold was just as absurd as an attempt to fix the market price of corn, or anything else.

20. When gold was first coined into money, the silver penny was the only legal standard, and the relative value of a pound of silver and of gold being supposed to be ascertained, it was determined to have gold coins representing a certain number of shillings, and accordingly the weight of bullion put into a gold coin, was conformable to the supposed market value of the two metals. This weight was altered several times, as may be seen in the table subjoined to Chapter VI., and the last time it was altered was in 1717, when the pound of gold was coined in 44½ pieces of the value of 21s. each at the relative value of the metals in those days. Since that time, first custom, and then law, substituted gold instead of silver as the legal measure of value, and instead of altering the weight of the gold coin to make it conform to its market value in silver, it was determined to adhere to the weight

of the gold coin as then existing, and make that weight of gold, the standard unit of value. Now, if $44\frac{1}{2}$ pieces of the value of twenty-one shillings were coined out of the pound of gold, that is equivalent to £46 14s. 6d. in pieces of twenty shillings. At the great re-coinage in 1816, it was determined to coin pieces of twenty shillings instead of twenty-one shillings, and it was enacted that the pound of gold should be coined in 46 equal parts with a piece over, equal to $14\frac{1}{2}$ twentieth parts of one of these equal parts.

21. As the weight of every coin must be fixed by law, it is just the same thing to say, that a given weight of bullion must be coined into a certain number of pieces; now, by law a pound weight of bullion is coined into pieces of equal weight, and each of these is called a pound or sovereign, and for the convenience of account, each sovereign is divided into twenty parts, which are called shillings, but as it would not be convenient to coin these shillings in gold, as they would be so very minute as to be troublesome, coins in silver are struck to represent them.

22. In speaking of the value of articles, the more valuable it is, the smaller is the unit generally used in estimating it. Thus, we reckon the price of coals by the *ton*; of corn by the *quarter* or *bushel*; of tea and sugar by the *pound*; and in articles so valuable as gold and silver, we do not use a unit even so large as the pound. If it were usual to do so, the confusion respecting the term, Mint price of gold, would not have arisen; the unit of value of gold and silver is the *ounce*, and diamonds and other precious stones, are reckoned by the *carat*. The price of gold is reckoned by the ounce. Now, as a pound of gold is coined into £46, and $14\frac{1}{2}$ twentieth parts of a pound, which are called shillings, we may say that the price of a pound of gold is £46 14s. 6d., and the price of an ounce of gold is one-twelfth part of that sum, or £3 17s. 10½d. The simple meaning of this is, that the law directs that out of every ounce of gold, there shall be

coined three pieces of equal weight, in such a manner, that there shall remain over a quantity equal in weight to 17 twentieth parts, and $10\frac{1}{2}$ two hundred and fortieth parts of one of those three pieces.

23. In the expression that the Mint price of gold is £3 17s. $10\frac{1}{2}$ d. per ounce, we see that the 17 does not mean 17 shillings in *silver*; but only 17 twentieth parts of a gold sovereign or pound. Taking bullion to the Mint and selling it there, is nothing more than exchanging a certain quantity of uncoined metal for a similar amount of coined metal; and supposing that no charge is made for the workmanship of coining it, it is perfectly clear that a certain quantity of the metal in one form, can never differ in value from the same quantity in another form,—it is absurd on the face of it, to suppose that the value of gold in coin can ever differ from the value of gold in bullion, *so long as the coins contain their full legal weight*,* and there are no extraneous circumstances, which render it desirable for the owner of the metal to have it in one form rather than the other, and there are no obstacles to prevent him from converting it from one form into the other at pleasure.

24. Under the old state of the law, which made it illegal to export or melt the coin of the country, if bullion was wanted for exportation, the value of the metal in coin might often be diminished to the holder of it, simply from the obstructive nature of the law, that is, bullion might become slightly more valuable than coin, or the market price of bullion would rise above the Mint price, and it would do so in a certain proportion to cover the risk of breaking the law; but in the present day, when these barbarous ideas are happily exploded, and it is lawful to

* It is one of the absurdities that Montesquieu is betrayed into by the fundamental error of his conception of the nature of money, when he says, "Le prince établit une proportion entre une quantité d'argent comme métal et la même quantité comme monnaie." *Esprit des Loix*. Lib xxii., c. 10. Just as if the prince could alter the naturally existing proportion of quantities.

melt or export coin as freely as bullion, it is clear that no diminution in the value of the coin, or rise in the market price of bullion above its Mint price, can take place on that account, and as any one may exchange his bullion for coin at a moment's notice, by simply going to the Bank of England and demanding notes for it, it is quite clear that there can be no difference between the Mint and the market price of gold, as long as the coin contains the quantity of metal it professes to do. It would be absurd to suppose that any one would give 48 sovereigns for a quantity of bullion, that they could only have coined into £46 14s. 6d., if those 48 sovereigns were of their full nominal weight. Now, a pound of gold bullion must always be equal in value to a pound of gold bullion; but it does not always follow, that £46 14s. 6d. of coins will always contain their full legal weight of metal; in fact, we know that after a certain time, in the ordinary course of things, they will not do so; and when the current gold coin falls to a discount as compared with bullion, or if the same thing be expressed in other words, if the market price of gold exceeds the Mint price, it is an infallible sign that this depreciation in the coinage has taken place, and the difference between the Mint and the market price is the exact amount of the depreciation.

25. The simple meaning of this is, that we know that in one form the value or weight of the metal cannot vary; in the other we know, not only that it can, but is extremely liable to do so, and requires great attention to be paid to it to prevent it from so doing. Now, under a system of law which imposes no obstruction to the conversion of the metal from one form into another, nor imposes any mercantile disadvantage on the metal in one shape, rather than in the other, there can manifestly be no difference, as long as the coins are of full weight,—as soon as there is any difference, as it can only arise in one of the quantities, we know that it *has* arisen, and we are able to detect its amount. It is clearly to be understood that when we speak of the mint price of gold bullion, we

speak of its price when paid in *gold* coin, or what professes to represent *gold* coin, namely, bank notes; and when we speak of silver bullion, it means the price paid in *silver* coin. Thus, in the reign of William III. the mint price of silver was 5s. 2d. per oz., which meant that the law at that time ordered that a pound of standard silver should be coined into sixty-two shillings, but the silver coin was very much worn, and the market price of silver rose to 6s. 3d., the plain meaning of which was, that in the silver coin then generally current, there was only as much silver in six shillings and three pence as there ought to have been in five shillings and two pence, i. e., that 6s. 3d. only weighed an ounce. The difference between 5s. 2d. and 6s. 3d. was evidently the measure of the depreciation of the silver coinage, which was rather more than 20 per cent. The great re-coinage of the silver by Lord Halifax, restored the coinage to its par value, or the market price became the same as the mint price.

26. As the mint price of gold means the value of it expressed in *gold* coin, and the mint price of silver means the value of it expressed in *silver* coin, it is quite clear that it can make no difference in the market price of gold, whether gold be very abundant or very scarce. If the law requires an ounce of gold to be coined into £3 17s. 10½d. so long as the coin contains its full legal weight, it can make no difference in the market price, whether gold becomes as plentiful as iron, or as scarce as diamonds. For the sovereign must always continue of the same weight, whatever be the quantity of the metal. The value of gold may vary with respect to other things, it may purchase more or less bread, or meat, or clothes, at one time than another; but it is absolutely impossible that its value in bullion can ever differ from its value in coin. Those who say that an ounce of gold can be more or less valuable in bullion than in coin, maintain that things that are equal to the same are *not* equal to each other.

27. The mint price of gold, therefore, in its modern meaning, is nothing more than a public declaration of the weight of metal the law requires to be in the coin, which accidental circumstances have caused to be considered as the legal measure of value in this country; and an alteration of the mint price of gold would be simply an alteration in the standard weight of the coin, and would be the same thing in principle as an alteration of the standard yard measure. Those persons who ridicule the idea of having the mint price of gold fixed, should, if they be consistent, also ridicule the idea of having the standard yard measure fixed. Those who wish to let the mint price of gold follow the market price, should also contend that every tradesman should have his yard measure of as many inches as he pleases, because when the market price of gold rises above the mint price, it is precisely analogous to curtailing so many inches of the yard. This fraudulent curtailment of the measure of value has never been done since parliament has had the chief power in the legislature. But it was constantly done in former times when the Crown was more despotic than it is now, so that the pound in the present day is curtailed of two-thirds of what it was in William I.'s time.

28. An alteration of the standard is a direct fraud upon debtors or creditors, according as it is raised or lowered; because the essence of every contract is, that the debtor is to pay a certain weight of gold, and not so many abstract ideas which are called pounds. Hence, if while any contract is incomplete, an alteration takes place in the weight of the coins, if when it is fulfilled the debtor only looks to the number of the pieces, neglecting their weight, it is evidently a fraud upon the creditor. Suppose a cloth manufacturer were under contract to deliver so many yards of cloth, and before the delivery took place, the law was to reduce the yard measure to 30 inches, surely the purchaser of the cloth would not be satisfied with receiving the same number of these diminished yards, simply because they were called "yards" as he

bargained for. On the contrary, he bargained for a certain definite *length* of cloth, and if when the law diminished the yard to 30 inches, it is also declared that the cloth manufacturer had fulfilled his contract when he had delivered so many yards of this curtailed measure, it would be clearly a fraud upon the purchaser.

29. It is clear, however, that this fraud and injustice would only extend to existing contracts. If the law were to reduce the yard in that manner, all contracts made subsequently to that law would adapt themselves to it, and the injustice would be just the more severe in proportion to the number and amounts of contracts existing when the change took place. But suppose that while the legal yard continued to be 36 inches, from the inattention of government to send round proper inspectors of measures, tradesmen had become so fraudulent as to cut off gradually several inches from their yard measure, and suppose that this was done so openly and universally that numerous contracts were entered into, in these measures, which were known by both parties to be below their legal length, so that contracts were subsisting that were made both in the proper measure and in the diminished measure. Now, suppose that the government being suddenly roused from its inattention, determined to enforce the legal length of the yard measure, it might become a question of some perplexity to decide whether equity would be more satisfied by enforcing a general return to the original legal standard, or by lowering the legal standard to the average length of the yard in use.

30. From the preceding considerations it evidently follows that the Mint price of bullion regulates the foreign exchanges, at least with those countries where an absolute standard of weight and purity is preserved. Though with those countries which have a mixed currency, liable to deterioration like our own, the state of their currency compared to our own modifies the exchange. If the market price rises above the Mint price, it must be imme-

diately followed by a fall in the foreign exchanges, for the very same reason, because if the coin be diminished in weight, it will not purchase the amount of bullion it ought to do either at home or abroad; and it is also clear that an alteration in the Mint price will be necessarily followed by a corresponding change in the par of exchange with every other country.

31. We may add a further illustration. Suppose a bank to issue notes, which of course promise to pay the bearer gold on demand. While the bank is in good credit, these notes will pass at their full value, but if the public have doubts of the solvency of the bank, they will either return them immediately for payment to the bank, or they would only receive them for part of the value they professed to represent. They would become depreciated or fall to a discount, and that depreciation or discount would be measured by the difference between the nominal and the current value of the notes. It is just the same with the coin. The note promises to pay so many gold coins; the gold coin purports to contain a certain amount of gold. The market value of the note is the test of its depreciation, the market value of the coin, or its power of purchasing the legal amount of bullion, is the test of its depreciation, and the difference between the market value and the nominal value is in each case the measure of the depreciation. The words on the note are the guarantee of the banker that the holder of it can get the specified amount of coin at will, the stamp on the coin is the guarantee of the state that it contains a certain weight of gold bullion. When the paper currency does not pass at its full value, it is said to fall to a discount, so when the gold coinage will not purchase its full value in bullion, it has fallen to a discount.

32. We see, then, under the system of free trade in coin and bullion that we enjoy, it is in fact bringing the foreign exchanges home to our own door, and it is a more delicate test of the state of the coinage than the foreign exchanges, because it is far more quick in its action, and

the distance of place, and the time and expense required for the transport of bullion from one country to another, always permits oscillations of a certain magnitude to occur without a remedy, whereas the test of the price of bullion always acts instantaneously. We may, therefore, recapitulate the principles which the foregoing observations are intended to demonstrate. That so long as the coin maintains its full weight and purity the value of coin and bullion must be identical, and if any cause arises to diminish or enhance the value of bullion, the value of coin must fall or rise with it; and if any difference arises between the two it must be from a depreciation of the coinage. That an alteration of the Mint price of gold means an alteration in the weight of the coin, and that the supposition that the value of gold in reference to any other commodity than itself is indicated by the expression "Mint price," or affected by the Mint price being fixed, is an error arising from a misapprehension of the expression Mint price.

33. So long as the market price of gold or silver exceeds the Mint price, it is evident that if any amount of bullion be converted into coin its value will be diminished in the same proportion, no one will convert bullion into coin. During the degraded state of the coinage during the last century, the market price of silver always considerably exceeded the Mint price. Adam Smith says that the market price of silver ranged from 5s. 4d. to 5s. 8d. an ounce before the re-coinage. And we find it stated in the second Report of the Lords' Committee of Secrecy in 1797, p. 257; "But as the Mint price of silver bullion has been during nearly the whole of the present century, considerably less than the market price of this precious metal, the silver bullion imported could not be converted into coin, but having left a quantity sufficient for the use of our manufacturers, must have again been exported, and did not contribute in the smallest degree to augment the coin of this kingdom."

34. Gold coin can never be more valuable than bul-

lion, unless it were to contain a greater amount of metal than it professed to do, except by a sum which represented the interest due for the time a private person had to wait while it was being coined. If coin were more valuable than bullion, every one who had bullion would immediately bring it to be coined, or demand notes for it.

35. If while the Bank of England were subject to their present law of being compellable to pay notes in exchange for bullion, at their present rate, the market price of bullion were to rise above the Mint price, it would in a short time be fatal to the Bank; for while their notes which represent coin would only buy a diminished quantity of bullion, they would be compellable to pay full weight for them, a process which would evidently exhaust their bullion, for nobody would be content to have a bank note in his possession which would only pass for 15s. in the open market, when he could compel the bank to give him 20s. for it. Such a state of things would therefore necessarily cause a run upon the Bank, which would not stop while any of its notes remained out, or until the value of the note was restored to par. It was such a state of things, which we shall see compelled the Bank to stop payment in 1697, three years after it was founded. The Bank received all the worn and clipped coins at their full nominal value, and gave their notes in exchange for them, when the new coinage came out, they were called upon to pay these notes in the new coinage, which of course produced a great demand upon them, which compelled them to stop. And the same state of things was grievously felt about 1774, and is the true explanation of the difficulties mentioned by Adam Smith,* which he attributes to over-issues by the Bank.

36. During Sir Robert Peel's administration, in 1844, the currency was beginning to exhibit symptoms of depreciation from its wear and tear. Owing to the effective measures taken by him, it is now almost universally of

* *Wealth of Nations*. Vol. II. p. 284. Wakefield's Edit.

full weight, and the deficiency in most cases is so slight; that it is not observable in ordinary transactions. The Bank of England, however, warned by experience, weighs rigidly every single sovereign paid into it by its customers, and does not credit them with more than its intrinsic value as bullion. Other banks in London find it impossible to maintain the same strictness with their customers, so that if they pay the money they receive in the course of their business into their account with the Bank of England, they generally incur some loss.

37. Although when the currency is in a depreciated state, the exchange will be apparently adverse with those countries which maintain their currency in its standard state, it is quite clear the exchange, as founded upon the commercial operations of the two countries, may be above, below, or at par, and it is a very simple matter to discover its true state, that is, whether it is favorable or the contrary, and the amount of its difference either way. The rate of the exchange, which arises out of the state of the currency, is called the **NOMINAL EXCHANGE**, the rate which arises out of the commercial relations of the country is called the **REAL EXCHANGE**. Thus, if we suppose that the exchange on Paris is 2,521 francs for £100 in gold at the Mint price, or when the currency is at its full legal weight, then if we suppose that, in consequence of the depreciation of the currency, the market price of gold bullion to rise to £4 3s. per oz., then the market price of £100 is £106 11s. 7½d. Now, suppose that the exchange on Paris is 23·80, or £100 will purchase 2,380 francs in Paris. Then, £106 11s. 7½d. would be able to purchase 2536·63 francs. But as the real par at the Mint price is assumed to be 2521, it is evident that the difference between these two sums is the extent to which the real exchange is in favour of London. We can also see the extent to which the exchange is depressed, because £100 at the above exchange will purchase 2380 francs, whereas they ought to purchase 2536·63 if they were of full weight; and the difference between these two sums

shews the extent by which the nominal exchange is depressed. Hence, we have the following rule. *Find the market price of the sum in London compared to the Mint or money price, multiply the market price so found by the rate of exchange, then if the result is equal to the par of exchange, the exchange is at par, and if there be a difference, the exchange is favourable or adverse according as the difference is above or below the par, and the depression of the exchange, caused by the depreciation of the currency is the difference between the sum so expressed in the mint and market prices, multiplied by the rate of exchange.* In the excellent state in which our currency now is, the question of the nominal exchange is of little importance, but it is impossible to understand the history of the currency in former times without it.

38. We must now consider the causes that affect the real exchange, or the true commercial one, which arises out of the transactions between this and other countries. As the British Islands do not produce the precious metals to any extent worth considering, they are only to be obtained in this country by importation, and we must now consider the various sources from which they come, and the different causes that produce an influx or efflux of them. They are to be treated in every other respect like any other foreign commodity, and are obtained by the same means as any other one that we require for domestic consumption which is not a native production.

39. The trade in bullion may be divided into two distinct branches: the one where it is carried on directly with the countries in which gold and silver are native productions, and the other with those countries which do not produce it, but which, like our own, have no means of supplying themselves with it except by foreign commerce.

40. I. *With bullion-producing countries.* Before the late discoveries in California and Australia, the chief bullion-producing countries were Mexico and Peru. We need not specify others, because the same principle

applies to them all, and to describe them all would rather belong to a work on commerce generally. British merchants have establishments, or correspondents, in these countries, to whom they consign their goods, and their agents exchange them for the bullion brought down by the natives, and which is collected in large quantities, and usually brought home by men-of-war for the sake of security. Most of the men-of-war on the Pacific and West India stations make a voyage along the coast before they return home to collect bullion from the merchants, and the captain receives a commission on the freight. In these countries bullion is treated exactly like any other commodity, such as tea, or wool, or wine, and the British goods of all kinds are exported to them for the express purpose of being exchanged for bullion to be remitted home. The limits of this exportation are precisely similar to the limits of the exportation to any other country. It is clear, that by the time the bullion reaches this country, it ought to be sufficient to cover the original price of the goods, and all the charges on them on their way out, as well as the agent's commission there, the charges for freight, insurance, and commission for bringing it home, and a fair mercantile profit over and above all these expenses. Unless it does that, the commerce is not profitable. If too many goods are exported to these bullion-producing countries, their exchangeable value with bullion falls, and they will not purchase a sufficient quantity of bullion to afford this profit, and the further exportation of such goods to these markets must be discontinued until the goods first sent out are consumed and fresh ones required. The purchase of bullion, then, in these countries, is a very simple affair, and requires no further notice.

41. II. *With countries which do not produce bullion.* The causes which produce an inflow or outflow of bullion, between this and other countries like it which do not produce bullion, are much more intricate, and have excited long and keen controversies. Taking this country as

the centre, we may consider that the transmission of bullion to or from it is influenced by the **SEVEN** following causes:—

1. The balance of payments to be made to or by it.
2. By the state of the foreign exchanges.
3. By the state of the currency.
4. By remittances made to this country, as the commercial centre of Europe, to meet payments due to other countries.
5. By the political security of this and neighbouring countries.
6. By the state of the money market, or the comparative rates of interest in this and neighbouring countries.
7. By the free or prohibitive commercial tariffs of this and foreign countries, as they permit or forbid our manufactures to be imported into them.

There are, then, seven different causes which act upon the movements of bullion, and in any case it is necessary to ascertain to which of these causes it is due. The inveterate error of mercantile opinion for a long time was, that there was only one cause which caused an export of bullion, namely, a balance of payments to be made.

42. We have already shewn that a degraded state of the currency has the inevitable effect of driving away bullion from here. As we may fairly hope that our currency will never again be allowed to fall into such a disgraceful condition as it was till 1816, we may consider that this cause is not likely to operate again on the bullion market; and we may now proceed to develop the system of the **FOREIGN EXCHANGES**.

43. According to the crude ideas that were generally received about a century ago, gold and silver were almost universally considered to be nearly the only species of wealth, and it was considered to be the true policy of every country to encourage, by every means in its power, the influx of bullion, and to discourage its export; and

most, if not all, of the European nations have gone so far, at one time or another, as to prohibit its export. The profit of foreign commerce was estimated solely by the quantity of gold and silver it brought into the country; and the theory of commerce seemed to be reduced to a general scramble among all nations, to see which could draw to itself most gold and silver from the others. According to this theory, the gain of one party was the loss of the other; every article produced in another country, and imported into this one, was considered to be a direct loss to the country. This was what was called the mercantile or commercial system. According to this theory, the leading maxim which governed the legislature was, to make the exports to exceed the imports; and the conclusion drawn was, that the difference, or balance, must be paid for in cash by the debtor nation. When two nations traded with one another, the difference of debts between them was called the "balance of trade," and when this was in favour of England, the exchange was said to be favourable, because bullion had to be paid to her; on the contrary, when, on the result of trade, payments had to be made by her, the balance of trade was said to be against her, and the exchange unfavorable, and then gold was sent out of the country. According to this theory, the prosperity, or the contrary, of the country, and the profit, or loss, of foreign commerce was exactly measured, according as gold had to be received or paid, or as the exchange was favorable or the reverse.

44. The admirable chapter of Adam Smith on the Principle of Mercantile System is a masterly exposition of the fallacy of this theory, and is certainly one of the soundest and best written in his whole work, from the more than usual consistency of its ideas, and the lucidity of its style. There are, however, some things relating to the subject which require further enforcement and illustration.

45. So far from the principle of the mercantile theory being true, that gold and silver are the most

profitable and desirable objects of import, the direct reverse is unquestionably true, that gold and silver are of all objects of commerce the most unprofitable; and it is a certain axiom of commerce in a state of freedom, *that bullion will not be imported until it has become unprofitable to import any other article.* There are no class of traders who derive so little profit, in proportion to the capital invested in their business, as dealers in bullion and money of all sorts, whether they be bullion merchants or bankers. Although the opinions we have alluded to above were the prevalent ideas of the age, there were not wanting a few sagacious thinkers, who discovered the truth of what we have last said, and maintained the unprofitable nature of gold and silver; but, like others who are before their age, their voice was unheeded, and the general object of commercial ambition and legislation was to accumulate treasures of gold and silver.

46. There is no expression in commerce of more frequent occurrence than the "balance of trade;" and it may be as well to give the interpretation of it generally received during the last century, and which is not yet wholly extinguished. "The common mode of considering that question has been to set off the value of the imports, as stated in the public accounts, against the value of the exports, and the difference between the one and the other has been considered the measure of the increase or decrease of the national profit."* And Mr. Hoare, a banker of eminence for twenty-two years, said, "I consider the only proper means of bringing gold and silver into this country to arise from the surplus of our exports over our imports, and that ratio or proportion which is not imported in goods must be paid for in bullion. In the year 1796, the imports of this country appear to be £19,788,923, and the exports appear to be £33,454,583, which ought to have brought to this

* Mr. Irving, Inspector-General of Imports and Exports. Evidence before Commons Committee of Secrecy, 1797. 3rd Report. p. 111.

country bullion to the amount of that difference, or £10,665,060.”*

47. We have made these extracts because they convey, in the fewest words possible, the whole ideas on the subject, and they are made by persons of great commercial eminence before the committee of the House of Commons. It is true that Mr. Irving, who was Inspector-General of the Exports and Imports of Great Britain and the British Colonies, expressly states that the application of this principle to the whole of the British trade would, in his judgment, be extremely erroneous. We, therefore, do not bring him forward as *approving* of the theory; but only as stating distinctly and authoritatively what it was. But Mr. Hoare, a banker of eminence and long experience, adopted it; and we believe that this theory of the balance of trade still retains a hold on the minds of great numbers of persons, who do not give themselves the trouble to sift it thoroughly. Nevertheless, there never existed a more complete chimera and pernicious delusion than this said doctrine of the balance of trade, nor one which has exercised so disastrous an influence on commercial legislation.

48. It appears that the simplest way of arriving at an accurate conclusion on the subject, is, to consider that the dealings between nation and nation are only made up of the aggregate of dealings between individuals of the nations, and we have only to consider the variety of methods in which an individual merchant may trade, to have an accurate and comprehensive idea of the commerce of the nation. Instead of dealing with figures of vast amount, which make no definite impression on the mind, and which are produced by a number of complex causes, we shall now proceed to consider in how many different ways an individual merchant may trade with foreign countries, and we shall shew, by considering the dealings of an individual, how utterly erroneous it is to

* Evidence before Commons Committee of Secrecy, 1797. 3rd Report. p. 82.

suppose that an influx of bullion is, *ipso facto*, a proof that commerce is flourishing and profitable to the country, and that whether it is so or not depends very much as to where it comes from, as well as a number of other circumstances.

49. With respect to those countries in which bullion is a native production, and to which we trade for the express purpose of obtaining it, we have already shown that unless the quantity obtained in exchange for our goods exceeds a certain amount, the commerce is not a profitable one, and that the simple fact of bullion being remitted from them, and therefore, though the exchanges with them must always be in our favor, it is no proof whatever of prosperity or profit.

50. Next, with respect to countries which do not produce bullion, it is easy to shew the extreme fallacy of the opinion that our exports should exceed our imports, and that the *difference* will be the *profit* of the country; in many cases the precise converse is true, that our imports should exceed our exports, and the profits are measured by the exact sum by which the imports exceed the exports, or the excess of what we receive over what we give.

51. To prove this, let us take a simple case. Suppose a merchant in London sends out £1,000 of goods to Bordeaux, by the time they arrive there, the mere addition of freight, insurance, and other charges, will probably have increased their cost of production, or the expense of placing them where they are, to £1,050, supposing them to be sold without any profit at all. But, as the merchant would never have sent them to that market unless he expected to realize a good profit, we may assume that the market is favorable, and that they sell for £1,500, and he would probably draw against his agent for £1,200. His correspondent at Bordeaux instead of remitting the money to England, would find it far more profitable to invest the proceeds of the goods in some native production, which would fetch a good price in England. The chief native production of that country

is *wine*, so the agent would invest the proceeds of the goods, after deducting all charges for freight, commission, &c., in Bordeaux wine, and send it to England. This wine would probably be sold at a considerable profit in the English market, say it would fetch £2,000, and after deducting all the charges of every description, on the cargoes both ways, the difference would be the merchant's profits. In this case it is quite clear that no bullion would pass between the countries, and the merchant would apparently import more than he exported, and it is also clear that his profits are exactly estimated by the excess of the value of the inward cargo above that of the outward one, after deducting all the charges both ways, and just as this difference is the greater so his gain is greater. In this case, as no bullion would pass from either country to the other, there would be no question of exchanges.

52. It is clear that the London merchant's agent at Bordeaux, would be governed by several considerations as to whether he would remit specie or wine to London, and he would be chiefly governed by the state of the wine markets, both at Bordeaux and London. For, supposing the goods to be sold at a good profit at Bordeaux, he must next consider the price of the wine at Bordeaux, and also what it might be expected to fetch in London. If some great disaster had happened to the vines so that there was a failure of the crops, the price of wine at Bordeaux might rule excessively high, but at the same time there might be a large stock of wine in London, and the price might not be unusually high; so that if he were to purchase wine at Bordeaux, and send it to London, it might be a loss. In such a case as this, if there were no other native production to send, he would find it most advantageous to remit specie, whatever he could sell the goods for, and then the exchange would be in favor of London; but before the London merchant could reckon his profits he would have to deduct the freight, insurance, &c., on the specie.

53. Whether the transaction was profitable or not to the London merchant would entirely depend on the amount of specie he received after deducting all charges, and if he had purchased the goods he sent out from England cheap, and there was a scarcity of them at Bordeaux, he might realize high prices there, which might leave him a good profit. It would be very improbable that he could realize so much profit on that single operation, as in the double one of exporting goods and importing wine. So that the import of the specie would be less profitable to him and the nation at large, than the import of the wine.

54. The reasons which caused the export of specie from Bordeaux, and the import of it into England, in this case, are very plain, they were the scarcity and dearness of the native productions at Bordeaux, and the abundant supply of them already in the London market. Hence, we gather that the scarcity and dearness of native productions is an infallible cause of the export of specie from a country; on the contrary, an already existing abundant supply of foreign productions of all sorts, is a certain cause of its import into a country. On the contrary, when native productions are cheap and abundant, it will cause an importation of bullion, and when foreign productions are scarce and dear, it will cause an export of bullion.

55. We have before observed, that the exchange being in favor of a country, means nothing more than that bullion has to be remitted to it, in the case above described, the exchange at Bordeaux would be in favor of London: but this simple case is as good as a thousand to shew the extreme and dangerous fallacy of drawing any conclusion, as to the advantage of the trade to England, from the simple fact of the exchange being favorable to her, and an influx of bullion taking place.

56. The example given above is of the simplest description, and a merchant of eminence, who had correspondents in several different parts of the world, might

easily multiply these operations, so as to visit many markets before the returns of his cargo were brought home. Thus, instead of having the wine sent home from Bordeaux, his correspondent might find it more profitable to send it to Buenos Ayres, and dispose of it there. The chief native production of that place is hides, and we may suppose that his correspondent there, might invest the proceeds of the cargo of wine in hides, which there might be a favorable opportunity of selling in the West Indies. When the cargo arrived in the West Indies, instead of remitting the proceeds directly home, it might very well happen that owing to a scarcity of corn at home, it might be very high there, and cheap in Canada, so he would invest the proceeds of the hides in sugar, and despatch that to Canada, where the merchant's correspondent there would dispose of it, and purchase corn, which he would send to England.

57. In the case just described, we observe that there are five distinct operations, and as we may suppose that there is a profit upon each of them, by the time the returns for the goods, which originally cost £1,000, are brought to England, it may very well be, that the corn which forms the ultimate payment of them, may be several times as valuable as the original cargo; and as we have supposed the charges on each operation to be deducted before investing the proceeds in other articles, it is clear that the merchant's profit upon the whole, is exactly the difference in value in England, between the articles last purchased and sent home, and the original cargo, after deducting all the expenses of sending home the last cargo, and we also observe that no specie has been sent from one country to the other in the whole course of the extended operation.

58. This example is sufficient to demonstrate the utter fallacy of the old idea, which is even yet not extinguished, of the balance of trade. Nothing can be more clear, that unless the value of the cargo which comes into England, in payment of the cargo that was

sent out, is sufficient, not only to defray the cost of the original cargo, as well as all charges upon it and the return cargo, and leave a profit besides, the commerce could not be carried on. No English merchant could export goods unless he received in return others of much greater value, and the obvious consideration that the more he gets for what he sends out, the more profitable it is to himself and the nation, is sufficient by itself to explode the old fallacy of the balance of trade. One obvious source of error is, that the value of the exports from this country is estimated at the time of their leaving the country, and before the charges for freight, &c., are incurred, which must necessarily raise their selling price in the foreign market, if they are not sold at a loss, and their value in that market is expected to be considerably higher than that. On the other hand, the value of the imports is estimated, not according to their value when they left the foreign country, but what it is upon their arrival here, including all the charges upon them.

59. If we suppose that Bordeaux had but one native production—wine, the chances of finding the markets, both at Bordeaux and London, in a favourable state for importing produce instead of specie, would be limited to that single article. But if it had other products, such as olive oil, the chances would be increased of finding articles to suit the market, and the chances would evidently be multiplied according to the number and variety of its productions.

60. Let us take another example, and let New York be the starting place. The staple productions of America are breadstuffs and provisions. A merchant of New York sends a cargo of corn to Liverpool, and his correspondent there will endeavour to invest the proceeds of that in British goods, if he finds the state of the markets in England and New York will make such an operation profitable. Suppose that the price of corn is very high here, and British goods are also very high here, and very low in America, it is clear that nothing but specie will be

sent. In cases when a great and unexpected dearth of corn occurs in England, and its price rises enormously high, the infallible result is to cause a great drain of specie for the time being, because our necessity for food is much more pressing and immediate than their necessity or capability of consuming our cotton or woollen goods. And the only way to arrest such a drain, is to effect such a reduction in the prices of British goods as shall make it more profitable to export goods than specie.

61. In the cases we have been hitherto considering, we have described the operations as if merchants were left perfectly free to carry their goods whither they pleased, and were not met and obstructed by artificial obstacles purposely devised for interfering with their business, by the laws of different nations. But there are few nations, and our own among the rest, which have not habitually discouraged the importation of foreign goods, and imposed heavy duties for the specific purpose of excluding them, as they conceived the extraordinary idea that all foreign goods brought into the country were so much loss to it. Thus, the statute of William III. (1688, c. 34,) says:—"It hath been found by long experience that the importing of French commodities of all sorts," (enumerating them) "hath much exhausted the treasure of this nation, lessened the value of the native commodities and the manufactures thereof, and greatly *impoverished* the English artificers and handicrafts, and caused great *detriment* to the kingdom in general."* If we consider the effect of these laws in one place, it will equally apply to every other; thus, in the first instance, suppose that there are very high protecting duties at Bordeaux against British goods, as the consumer must ultimately pay all the expenses and charges on the goods, it will have the effect of greatly raising the

* See also Craik's Brit. Commerce. Vol. II., 92. 29 & 30 Car. II., c. 1.1.30.

market price there, and diminishing the number of persons who can afford to buy them, and hence, as the market is so limited, a smaller quantity of goods will overstock it than if it were much extended. This will cause a much less quantity of goods to be sent from London, and it will cause a much larger proportion of specie to be remitted to pay for the productions of Bordeaux. This example shows that the inevitable effect of high protecting duties between country and country, is to cause a much more frequent transmission of bullion from one to the other than would be the case in an unfettered state of commerce; unless, indeed, the smuggler steps in, who is the corrector provided by nature against this commercial insanity. The effect, then, of prohibitive duties is to cause an influx of bullion; but we must carefully guard against supposing that this influx is a favorable sign, as it is certainly the least profitable import a merchant can receive for his goods; and there is this very marked difference between an influx of bullion under the Protectionist system and under a Free-trade system, that the former is accompanied with a great dearth of foreign commodities, but the latter is an infallible sign of a great abundance of them, as bullion is never imported when men are allowed to follow their own interests, until our markets are already so overstocked that every other article has ceased to be profitable.

62. The foregoing cases comprehend the different varieties of commercial transactions between this and any other country, and we gather from them the following results respecting the influx or efflux of bullion:—

I. The cause of bullion being imported is either when the price of goods is so *low* in England, and so *high* in the foreign market, as to tempt foreigners to send here to buy goods, or the price of goods is so high in the foreign market and so low in England, that nothing but specie can be sent in payment of goods exported from England.

II. The cause of bullion being exported from England is that there is some great and pressing demand for some article in this country, and other commodities are so scarce and dear that they cannot be exported with a profit, or that the article is required in such great quantities that the foreigner cannot consume our goods which we should prefer to send in payment fast enough, and so specie must be sent, and the greater the difference in price the greater will be the drain of bullion; or that other markets are already overstocked with our productions, which are depressed below their usual market value there. This is what is meant by overtrading, and from this circumstance we see that overtrading is a sure precursor of a drain of bullion from the country. When there has been a great failure in the crops in this country, so as to cause a famine price, the demand for corn is so immediate and urgent, that it necessarily causes a great drain of specie, and it is then of the greatest possible consequence, that the prices of other commodities should be as low as possible, to enable them to be sent in payment of the necessary supplies of food, and prevent such a drain of bullion as may disturb the whole monetary system of the country.*

63. Overtrading, and a failure of the cereal crops of this country, are each of them sure causes of a drain of bullion. The most disastrous event for the commerce of this country is when both these circumstances happen concurrently. It is like a spring tide of disaster. The most terribly disastrous commercial crisis this country ever experienced was preceded by some years of overtrading, followed by successive failures in the staple support of the people of England and Ireland. These two adverse events together produced the calamities of 1847. We shall see that the intended effect of the Bank Act of 1844 is to provide a remedy for such a state of

* See a striking example of this in Mr. Vansittart's speech, May 13th, 1811. Parl. Debs. Vol. xx. p. 25.

things, by causing such a reduction in the price of home commodities, in the event of a drain of specie taking place, as to render it more profitable to export them than bullion, and so stop the drain. Whether the act is effective for this purpose is another question, which it is not the proper place to discuss here.

64. There are some countries from which we draw articles of great necessity, but to which, from different circumstances, we do not expect to remit goods in payment. Russia was the great source of our supply of hemp, tallow, flax, and we used to import these products to the value of £12,000,000 yearly, but owing to the prohibitive character of her tariff, we were unable to send our own productions in payment of these goods to anything like a similar amount in value. To such a country the difference must be remitted in cash, to the mutual loss of both parties, and unless there were other means of equalizing the exchanges with different countries, the exchange with Russia would always be unfavorable to England. The chief export trade from Ireland to England was in articles of food—pigs, cattle, oats, butter. Great quantities of these came from Ireland, but the inhabitants of that country were much too poor to be able to consume an equivalent amount of English goods, in consequence of which the difference had to be remitted in specie, and so the exchanges between England and Ireland were almost uniformly favorable to Ireland.* Now, if Ireland had been sufficiently wealthy to have consumed English goods instead of specie, it is evident that it would have been far more advantageous for both countries; for English industry would have been promoted, and Ireland would have gained a more valuable import. These two examples offer a further illustration of what we said before, that the frequent transmission of bullion between countries which do not produce it, is a symptom of a less profitable trade than it would be if goods were transmitted.

* *Vide* Report of House of Commons on Irish Currency. 1804.

65. In the operation first described above, we have supposed it to originate with the English merchant who remits his goods to his correspondent abroad, and who reaps the profits, and the proceeds must be remitted to him after deducting the freight, charges, and commission, of the agent there. But it is also probable that there will be native merchants at Bordeaux, who will send wine to England on their own account, to their correspondents here, and then the whole transaction will be reversed. The English correspondent will endeavour to purchase English goods as low as he can, and if he can get them low enough to realize a profit in the Bordeaux market, he will send goods out, but if the English goods are too high for that purpose, he must send specie. It is also evident that even if the goods be at no unusual height in England, still if the market at Bordeaux be already overstocked with them, or as it is called "glutted," it would be useless to send more goods, to force the price down still further, and the consequence must be that nothing but specie will go.

66. From this we see that if specie be coming in from a country, it is a proof that we have already got so many of their goods, that it will not pay to import any more, and if specie be going out to a country, it shows that we have already sent out so many of our goods to that market that it is already overstocked. The different barbarous laws which every country has enacted under the erroneous appellation of protection, by aggravating the price, limit the markets in every country for the productions of other countries, and cause much fewer commodities to pass between nations than otherwise would, and cause the markets of any country to be much sooner overstocked than they would otherwise be. By preventing this interchange of commodities which every nation would naturally prefer, it necessitates payments in specie to a much larger extent than would be the case if commerce were free, to the common impoverishment of all parties.

67. The foregoing considerations shew that it is possible to carry on any amount of foreign trade without the necessity of any remittances being made in specie. In the instance above taken, the English merchant purchases goods and sends them to his correspondent abroad, who realizes them and invests the proceeds in that market, and sends them to England, and the English merchant disposes of them in England, and gains the profits there, and no specie is sent from one country to the other. Similarly the foreign merchant sends his goods to his correspondent in England, who disposes of them there, and invests the proceeds of them in England in English commodities, and sends them to his foreign correspondent, who gains his profits, either by selling them in his own country, or by sending them to some other market where he may make a higher return, and, as in the former case, no specie passes between the two. Nor is the result in any way different, if the trade be conducted by the more circuitous method of three or more transactions. Hence, in a healthy state of the markets of different countries, scarcely any specie will pass between them, and the very fact of there being a necessity for making frequent and large remittances of specie from one country to another, is in itself a proof of there being something irregular and unhealthy in the state of commerce in general, and in the state of the markets of one country or the other, either that they are overstocked or understocked, or that there is some legislative interference with the natural course of trade between nation and nation. Nothing can be more certain than that bullion is the least profitable of any article of commerce, except from bullion-producing countries, and that when merchants have recourse to it, it is because some disturbance has taken place in the profitable relations between supply and demand of other commodities.

68. Now, supposing commerce to be in that desirable and healthy state in which no specie passes between non bullion-producing countries, who could tell how

what is commonly called the balance of trade is inclined? Who can tell what the balance of trade is? Each country would shew a favorable balance, taking the values of the exports and the imports at their market prices in each country. Each country would shew that their imports exceeded their exports in value, that is, each would shew that they had gained by their commerce, for the very simple reason that the value of the article they received would be greater in their own market than the value of the one they gave; and unless it was so it is manifest that trade could not be carried on, because all the expenses and profits of trade are provided for by the difference in value between what they give and what they receive. Hence, unless both parties gain by the transaction, commerce cannot be carried on. But, this shews that the expression of the "balance of trade" is a gigantic delusion, and it is greatly to be wished that it should be for ever exploded and laid aside, as the fountain and origin of incalculable mischief to the world, in the suicidal efforts every nation has made to secure to itself that great chimera—a favorable balance.

69. The mistake of unreflecting writers, who think that the price of foreign goods sold in this country goes into the pocket of the foreigner, consists in this, that the probability is that the English merchant who imports these goods has already purchased them with English goods, so that their money price goes into the pocket of the English merchant, and not that of the foreign one, and is, probably, re-invested in English goods if there is a prospect of a favorable opening for them.

70. The fundamental fallacy about the balance of trade which seems to have taken possession of the legislature, was, that the interests of the State were different and opposite to the interests of individuals. They seem to have entertained the idea that every merchant had entered into a conspiracy to ruin the country, which he tried to carry into effect by becoming as prosperous himself as he could. It seems most unaccountable how long

they missed the obvious truism, that the prosperity of the State was made up of the prosperity of the individuals composing it, and that every one was far keener in discerning what conduced to his own prosperity than the State could be, and that if private merchants found it to be their individual advantage to import commodities rather than bullion, it could not be beneficial to the State to force trade into a contrary direction.

71. When our ships first traded with the South Sea Islanders, they took out with them axes, beads, and other trifles, which had very little value in this country, and bartered them for all sorts of curiosities, shells, &c., which were very valuable in England. A pair of fine shells from the South Seas in many cases is worth ten guineas in England, which perhaps an English Sailor obtained in exchange for an axe worth 2s. 6d. The English sailors thought the natives very simple to give away so many valuable curiosities for such common things. We cannot doubt that the natives had exactly the same opinion of the English sailors; they thought them great simpletons to give away such valuable things as axes, beads, &c., for so common things as a few shells. Each party, however, exchanged what was common and cheap in his own country for what was scarce and valuable. The axes were infinitely more valuable in Feejee than the shells, the shells were many times more valuable in London than the axes. Thus, an English sailor by giving perhaps 2s. 6d., gained in exchange what was worth ten guineas, and the difference was his profit. Now, this was the genuine spirit of commerce. The coloured beads were just as valuable to the poor untutored savages as diamonds to civilized Europeans. The commerce between all nations is exactly similar in principle to that between the sailors and the savages. But according to the old doctrine of the Balance of Trade, this difference between the values of the axe and the shells in England, ought to have been paid in bullion. This simple case is quite sufficient to explode the whole fallacy.

72. Notwithstanding the prevalent idea that foreign trade was profitable just in proportion to the money it brought into the kingdom, and that this was indicated by the so-called balance of trade, there were a few enlightened persons who saw through the fallacy and combated it. In reference to a certain "balance" which occurred in the trade between Holland and England, and which was a subject of much gratulation, Craik well observes,* that it would be as irrational to suppose that the English must necessarily be the chief gainers by this trade, as it would be to maintain that the productive laborer must always be a greater gainer on the article he produces than the capitalist who employs him. That the Dutch were in the position of the capitalist, and the English of the laborer, and that while the Dutch had the goods the English had the money; just as, while the master has the goods, the workman has his wages. But that the excess of profit, or real advantage, should be with the laborer rather than with the capitalist, may fairly be presumed to be as unusual, and as little likely in the nature of things, in the case of nations, as of individuals.

73. An attentive consideration of these various methods of trading will shew what a complete phantasy the old, and still too common, idea of the "balance of trade" is; and as nothing more conduces to error and confusion in any science than a nomenclature and technical phrases which are founded upon misconceptions of the principles of that science, so nothing has exercised a more malignant influence upon legislation, and popular ideas generally, than this phrase; and it would be very desirable if some means could be taken to discontinue its use altogether. But as it does occur in the course of trade that transactions between nations have to be settled in specie, we must now consider the operations of the foreign exchanges.

74. The course of the foreign exchanges, then, en-

* History of British Commerce. Vol. II., p. 155.

tirely depends upon the fact of persons in one country having to make payments to persons in another country, from whatever causes these payments have to be made. And there are but two causes which influence their rates: first, the depreciation of one or both of the currencies which have to be exchanged; secondly, the relative amounts of money that have to be remitted from one country to the other.

75. Between two cities, say London and Paris, whose natural intercourse was not impeded and obstructed by barbarous laws, it would probably happen that the debts of the merchants of London to those of Paris would be about equal to the debts of the merchants of Paris to those of London, in an ordinary state of commerce. Thus, if A of London is the creditor of B of Paris, and B¹ of Paris is the creditor of A¹ of London, to equal amounts; then, instead of B of Paris sending the actual money to A in London, he may go to B¹ in Paris, and pay him the money, and so purchase from him the debt due to him by A¹ in London, which he would send to A; and A, on presenting the bill to A¹, would receive the money; and so all the debts would be settled without transmitting any bullion between the two places. In such a case as this, as the full value would be given for the bill, the exchange would be said to be at par.

76. Supposing, however, that while the exchanges were in this state of equilibrium, in which the demand and supply of bills, both in London and Paris, were exactly equal, that is that each of them would have to send and receive the same sum, it should happen that from any cause whatever, no matter what, there should be a desire on any particular day to send more money from one side than it had to receive. Let us suppose, for instance, that on any particular day London should wish to remit to Paris £105, when it only had to receive £100, it is evident that the demand in London for bills would be £105, and the supply only £100. But as the London merchant has to provide for his debt in Paris,

and the cost of transmitting the bullion falls upon him, it is evidently his interest to give a little more than the £100, in order to save this expense of transmission; and it is very evident that this limit is the cost of sending the money from one place to the other, or about 15s. Consequently, if the competition for bills increases, the price of a bill in Paris will rise to that extent; but it will not go beyond that limit, for then it becomes cheaper to send bullion. It is clear, therefore, that those who are in time to buy bills at that price will do so, and those who come too late, when all the bills are sold, must send bullion. In such a case as this, bills on Paris would be said to be at a premium. On the other hand, if similar circumstances took place at Paris, bills on London would be at a premium.

77. In this case we have supposed the demand at either place to exceed the supply, or to increase from par—but it is quite manifest that the reverse case may happen, and that the demand at either place may fall short of the supply, and then the phenomena will be reversed. For in such a case the Paris merchant wishes to *sell* his debt on the London market, in order to avoid the expense of transmitting bullion from Paris to London, but as the expense of sending that is known, it is clear that he will not sell his debt for any sum lower than the expense of sending bullion, and consequently he will not sell his debt for a lower sum than £99 5s., and the competition of merchants to sell their debts may lower the exchange to that limit, but not beyond, and those merchants who cannot get any one to purchase their debts at that price will be obliged to send bullion to discharge them.

78. We thus see that the state of the exchanges arising out of the cross remittances of money is a simple example of the formula for prices in our second chapter, with the exception that the variation in the rates of exchanges never can exceed a certain definite sum, namely twice the cost of sending bullion from one place to the

other; thus, if London be taken as the standard, the range of variation of the exchange with Paris can never exceed 80s., either 15s. above par, or 15s. below par. For if the state of demand and supply would have a tendency to cause a greater variation than that, a transmission of bullion immediately arises.

79. The exchange between the whole city of London or England and the whole city of Paris or France is simply the sum of the transactions of each individual transmitter of money, but as individuals would lose a considerable time in going about discovering what other persons had to receive remittances, or wished to transmit them, that is, those who wished to buy or sell bills, there are persons who make it their business to act as agents between the purchasers and sellers of these bills. Thus, if any London merchant has a debt to receive from Paris, he endeavours to *sell* the bill on the Exchange, and if he has a debt to pay in Paris he endeavours to *buy* a bill on the Exchange. The competition between the buyers and sellers of bills will act exactly in the same way in causing their prices to rise and fall as the prices of other commodities, always bearing in mind that the difference paid as a premium for bills will never exceed the cost and charges for remitting the specie itself, and when all the bills against the country which has the smallest amount of cash to send have been set off against the bills upon that which has the largest amount to send, the difference must be sent in specie. And though any single merchant might have great difficulty in ascertaining the proper rate of exchange between two countries on any particular day, yet when all these debts and credits are brought into one great focus, as the Exchange, which is the great debt market of Europe, their market value is settled just in the same way as that of any other commodity.

80. When one country, say London, as the representative of England, has a sudden necessity to make purchases of a large amount in another, as, for instance, to buy corn in New York, owing to a failure of the crops

in England, before New York has had the time or necessity of making an equal amount of purchases in London, it is quite evident that a greater quantity of bullion must be remitted to New York to settle accounts than *vice versâ*. Consequently bills on New York will be at a premium, and the exchange is said to be adverse to London, which means that a higher price must be paid in London for a bill on New York than it purports to represent, and if the premium rises beyond a certain amount, then bullion begins to flow out. On the other hand, if New York suddenly commissions a quantity of goods from London, before London can require an equal amount from New York, it is evident bills on New York being in excess of the demand, the price of them will fall to a discount, and the exchange is said to be in favor of England, because it requires a less sum of money in England to purchase a bill on New York than it purports to represent, and as soon as the discount exceeds the cost of transmission of bullion, it will flow in.

81. When, therefore, the exchanges are unfavorable, it shews that bullion has a tendency to leave the country, and when they are favorable that it has a tendency to flow in, but in neither case will it actually do so, until the difference exceeds the cost of transmission of bullion.

82. When the exchanges are so adverse to England as is described in the last section but one, if the English debtors could purchase goods cheaply in England, which would sell in the New York market for the amount of their debts, they would of course prefer to send them, but if commodities are too dear in England, or too cheap in New York, from overabundance, it is clear that nothing but bullion will be sent; and bullion will continue to be sent, unless the prices of English goods can be so reduced or the price in the foreign market raised. As it is wholly out of the power of English laws to raise the prices in foreign markets, we shall see hereafter that it is one of the objects of the present banking laws of England to compel such a reduction in the prices of home goods as

shall enable them to be exported instead of specie, under the circumstances we have been considering.

83. Such a state of things as this would not last for any continuance of time between two countries whose intercourse was free; and it would have a natural tendency to correct itself, because the transmission of bullion between two such places as London and New York is the least profitable species of traffic that can be. Such a violent and sudden disturbance of the usual course of exchange is usually caused by a great and sudden dearth of some article of great and pressing necessity. Thus, the terrible failures of the potato and grain crops in the United Kingdom caused a sudden, and imperative, and immediate demand of food for instant use. Such a deficiency as this would require to be satisfied far quicker than any demand that could arise from home goods would operate to restore the exchanges, and the payment of such quantities of corn as were required could only be made in specie. Thus, New York, which may be taken as the centre of American trade, is the great market for corn and breadstuffs. When the great failures in the British crops took place, immense importations were rendered necessary, but there could be no corresponding demand for English goods of equal rapidity, so that it became necessary to pay immediately for the corn with specie, and not with goods. Consequently, the exchange became adverse, and bullion flowed out in great quantities.

84. This state of things, however, had a natural tendency to correct itself. The Americans having a great quantity of money poured in upon them for their corn, had a natural impulse to purchase, and in the course of time they sent over large orders for English manufactures, and the necessary consequence of food being at a high price was, that manufactures were low, and so very large exports of our goods took place, larger in amount than we required to be returned in corn, and so, after some time, the Americans had to remit money for their purchases in the English market, and the exchanges again

became favourable, and the specie which had been exported in payment of the corn was brought back again to England in payment of the goods, and the former state of things was restored.

85. This violent disturbance of the usual state of trade, and the abrupt oscillations of the exchanges, first one way and then the other, were unprofitable to both parties on account of the loss occasioned by the double transmission of specie. Moreover the enormous efflux of specie on several occasions caused serious alarm in the minds of statesmen of this country for the stability of our paper currency, which all purports to be payable in coin to bearer on demand, and we shall see the professed intention of the Bank Act of 1844 is to enforce a diminution in the quantity of Bank of England notes in the same ratio as the specie in its coffers diminishes.

86. Some writers insist that an unfavourable state of the exchanges is an encouragement to exportation. Thus, if the exchanges between England and any place are unfavorable to England, the bills upon that place will sell at a premium in the London market, and if a merchant sends goods there, and draws bills upon the place, he can sell them at a trifling premium, and to that extent he can afford to purchase goods at a higher price than if the exchanges were more favourable. But the extent to which this can operate as an inducement to export to any particular market must be so exceedingly minute, that we much doubt that it can have any practical importance; and the terms used by some of these writers seem to be somewhat wanting in clearness, as to the cause of the state of the exchanges. Every merchant who has a debt to pay to a foreign country, will always endeavour to pay that debt in goods, rather than in specie, whatever be the state of the exchanges, if the state of the prices in the two markets will let him do so at a profit, and it is the state of the prices in the two markets that governs the state of the exchanges, as we have seen in the operations previously described in this chapter. It

is certainly undeniable, that if a merchant can discover goods which can be profitably remitted in an unfavorable state of the exchanges, he may derive a small additional profit upon that account: but it is very small, and a small comparative increase in prices will annihilate it altogether. This small margin does undoubtedly afford a slight additional inducement to export, but it is so very minute, when at its greatest extent, that it can have no influence in any great emergency: and we have already said that the exchanges being unfavorable at all, is a proof that this limit has been passed. The fact is that the exchanges do not become unfavourable until *after* the merchants have taken all these things into their consideration. It cannot be too carefully observed, that merchants will not export specie except in the last resort. They will exhaust every other device before they come to that, and the exchanges do not become unfavourable until they find that there is no commodity which they can export to pay their debts with, and there is no question of exchanges until the necessity arises for transmitting specie. To say, then, that an unfavourable state of the exchanges makes it profitable to export, seems very like offering a cheap bargain to a man who has no money to buy. So that we may say that the state of the exchanges is the *result* of the operations of exporting and importing, and the prices of articles and the state of the exchanges are not the *causes* of export and imports.

87. We have seen by the preceding considerations that there are two separate circumstances that influence the figures, which denote the state of the exchanges between any two countries, at any particular time. The first is the relative intrinsic condition of the currency of each country, and secondly, the comparative remittances from whatever cause arising, that have to be made from one to the other. The first is called the **NOMINAL EXCHANGE**, and the second the **REAL EXCHANGE**. And these two causes may always operate in similar or contrary directions, and the actual result will be a modifica-

tion of the two. Now, we have endeavoured to show that the *real exchange* can never vary beyond certain limits, which are always capable of being ascertained to a very great degree of accuracy. But the first cause, or the *nominal exchange*, may vary to any extent whatever; there is no limit to the depreciation which the national currency may undergo—as, for instance, under the issue of *assignats* by the French revolutionary government—and so the foreign exchanges may sink to any state of depression. Now, if we observe the exchanges for any continuance of time, and see that they continue depressed to a greater extent than the real exchange, which is by nature limited, will warrant, we arrive at the irresistible conclusion, which is the great axiom that connects the relations of the currency and the foreign exchanges—*That if the foreign exchanges continue depressed for any length of time beyond the limits of the real exchange, THAT EXCESS IS THE PROOF, AND THE MEASURE, OF THE DEPRECIATION OF THE CURRENCY.*

88. It is, of course, scarcely necessary to observe that this rule only applies to the exchanges with those countries, which like Hamburg, Amsterdam, or Venice, always guaranteed an absolute maintenance of the legal standard, or like France, which ever since the restoration of specie payments, after the abolition of the *assignats*, has always maintained her currency at its full weight and purity. With countries like Portugal, which allowed its currency to become depreciated, the nominal exchange with England would of course vary according to the comparative depreciation of the two currencies.

89. This principle, connecting the currency and the foreign exchanges, is evidently identical with the one we have before considered respecting the mint and market price of bullion. They both simply arise from placing the currency in a position where it will have no estimation beyond its intrinsic value as bullion, and withdrawing it from one where it is influenced by the local associations of popular opinion. The test of the home

market of bullion is more satisfactory, because it is more rapid in its action, and the differences that may arise from the advantage of having the metal in one form or the other are reduced to a much narrower limit than the real exchange between any two countries, and are not so liable to vary. But though the necessary correction to be applied is somewhat more intricate in one case than the other, the *principle* is identical; and we may now recapitulate the incontrovertible axiom on the subject in the following words:—

The rise of the market price above the mint price of gold, beyond a small quantity denoting the cost of changing the metal from one form to the other, and a fall in the foreign exchanges beyond the limits of the real exchange, ARE THE PROOF AND THE MEASURE OF THE DEPRECIATION OF THE CURRENCY.

90. This law which carries with it the most self evident conviction to any one who is capable of understanding the reasoning upon which it is founded, was a subject of great contention for about 20 years in the beginning of this century. Some traces of it are discoverable in earlier writings, but it never assumed practical importance until the paper currency, or the issues of the bank of England, were inconvertible and unlimited. In accordance with what seems just, we shall call it Lord King's law of the currency; not because perhaps he was the first to think of it, but he certainly bore the most conspicuous part in establishing it. It is the corner stone of the whole currency question, and must be carefully impressed upon the memory. No doubt its utility is in abeyance at present, but the time may come again, when it may be useful.

91. We may endeavour to enforce this expression by another form. If the coin is depreciated below the standard, the market price of bullion must rise above the mint price, and the foreign exchanges must fall, because in the former case is expressed how many of the depreciated pieces will be required to purchase a fixed amount

of bullion, and of course *more* bad pieces are required than good ones. In the latter is expressed the number of good foreign pieces a fixed number of depreciated pieces will purchase. In the one case it is what number of pieces will be required to purchase a fixed amount of bullion, in the other how much bullion will a fixed number of depreciated pieces purchase. Hence, it is clearly seen that one must fall necessarily, by exactly as much as the other rises.

92. It has several times happened, that when the nominal exchange was against England, on account of the depreciation of the currency, the real exchange was in her favor. Thus, in 1694, the nominal exchange between London and Amsterdam was 25 per cent. against England on account of the depreciation of the currency; but the real exchange was in her favor, and so diminished the apparent depression.

93. Between countries in which there are no restraints upon trade, the exchanges will never vary very much, except on some sudden emergency; but there are countries with which, owing to the prohibitive laws which still infest their commercial codes, the exchanges are permanently unfavorable, because they will take nothing but bullion for their commodities. Russia is one of these countries, and hence, if not modified by other circumstances, bills upon Russia would always be at a premium; but here again the effect of trafficking steps in, which always has a tendency to equalise prices. The merchant (if we may call him so) who deals in bills, acts upon the same principles as the dealer in any other commodities, he buys them where they are cheapest, and sells them where they are dearest. Hence, he will try to buy up Russian bills cheap in other exchanges, or debt markets, and sell them in the London debt market. On the other hand, from the course of trade between England and Italy, the debt which Italy owes to England is usually greater than the contrary; hence, Italian bills will usually be at a discount, or cheap, in the London debt market.

So the bill merchant buys them up cheap here, and sends them to some other market—Paris, for instance—where they may be at a premium. By these means, the price of bills is raised where they are cheapest, and depressed where they are dearest; and the general result will be to melt all the differences between separate countries into one general result, so that the exchanges will not be favorable with one country and adverse with another, but they will be generally adverse or favorable with all the rest of the world.

94. Supposing, however, a merchant has to remit money to Paris while the exchange with Paris is unfavorable to England, he may possibly discover a more advantageous way of remitting it than by buying a bill on Paris directly. Thus, for instance, while bills on Paris are at a premium in London, those on Hamburg may be at a discount, and bills on Paris may be at a discount in Hamburg. So if the merchant buys a bill on Hamburg and sends it to his agent there, and directs him to purchase a bill on Paris with the proceeds, he may be able to discharge his debt in Paris at a less sum than he would have to pay for a Paris bill in London. This circuitous way of settling his debt involves additional charges for brokerage, commission, postage, &c., but the effect of it is still further to equalise the exchanges between London and all other countries. This circuitous method is called the *arbitration of exchanges*, and the sum which is given in London for the ultimate price it realises in Paris is called its arbitrated price. When only three places are used in the operation as above, it is called *simple arbitration*. When more than three are employed, it is called *compound arbitration*. The practical rules for working out these results are very simple, and will be found in any technical book on the subject. But it is very evident, that the quicker, safer, and cheaper the communication between countries become, the less room will there be for such operations, because the limits of the variation of the real exchanges, which are the

margin which renders such transactions possible, will constantly diminish.

95. When one country is indebted to another in a very large sum of money, or when one country agrees to lend a large sum to another, the method of transmitting it to the best advantage to the remitting country is an operation of considerable nicety and delicacy. If the sums to be remitted were very large, the expense and danger of the transit of the coin would have been very considerable in former times; but since the introduction of railroads, and greater internal security, such considerations would have little influence at the present day. But an actual and sudden withdrawal of a very large amount of bullion from a commercial country would cause the most disastrous consequences, when so many engagements had to be met at a fixed time. When such necessities, therefore, did arise during the last war, the operation was effected by means of bills of exchange, and the object to be obtained was, to prevent a sudden vacuum being caused in the currency of one country; but, by operating on all the different centres of payment of Europe, to cause a gradual and equable flow from all of them to the place of payment. We may give, as an instance, the following, as narrated by Mr. Boyd, who had the management of the operation. In the year 1794 the English Government agreed to make a considerable loan to the Emperor of Germany, and the money was required to be sent from London to Vienna, causing as little disturbance as possible in the English money market:—

“The remittance* of so large a sum as £4,600,000 I considered as a matter of infinite difficulty and delicacy, so as to prevent its producing any remarkable effects upon the course of exchange. It was necessary to vary the modes of remitting, and to make use of the various means for that purpose, presented by all the different exchanges of Europe. It was not necessary to remit bills upon

* Evidence of Mr. Boyd before the Committee of Secrecy of the House of Lords, 1797. p. 110.

Hamburg only, because it frequently happened that it answered better to remit to Hamburg upon other places, such as Madrid, Cadiz, Leghorn, Lisbon, Genoa, &c., than to remit direct upon Hamburg; and having constantly orders from Vienna with regard to the rates of the different remittances to be made, our attention was directed to the accomplishment of these orders, on the best possible terms. In fine, it was necessary to take bullion, bills direct upon Hamburg, and bills upon other places, all into our means of remittance, and to make the most of these modes of remittance without giving the decided preference to that mode which was the most favorable, because any one mode invariably adhered to, would soon have exhausted and destroyed that mode; whereas by turning occasionally to all the modes, and not sticking too long to any one particular mode, we had the good fortune to make upon the whole very favorable remittances."

96. We may mention another instance of a similar operation quoted by Mr. McCulloch:*

"In 1804, Spain was bound to pay to France a large subsidy, and in order to do this, three distinct methods presented themselves. First, to send dollars to Paris by land; second, to remit bills of exchange directly to Paris; thirdly, to authorize Paris to draw directly on Spain. The first of these methods was tried, but was found too slow and expensive; and the second and third plans were considered likely to turn the exchange against Spain. The following method by the indirect, or circular, exchange was therefore adopted. A merchant, or *banquier*, at Paris, was appointed to manage the operation, which he thus conducted. He chose London, Amsterdam, Hamburg, Cadiz, Madrid, and Paris, as the principal hinges on which the operation was to turn; and he engaged correspondents in each of these cities to support the circulation. Madrid and Cadiz were the places in Spain from whence remittances were to be made, and dollars were of course to be sent where they bore the highest price, for which bills were to be procured on Paris, or any other place that might be deemed more advantageous. The principle being thus established, it only remained to regulate the extent of the operation, so as not to issue too much paper on Spain, and to give the circulation as much support as possible from real business. With this view, London was chosen as a place to which the operation might be chiefly directed, as the price of dollars was then high in England, a circumstance which rendered the proportional exchange advantageous to Spain.

* Commercial Dictionary. p. 581. Edit. 1854.

"The business commenced at Paris, where the negotiation of drafts issued on Hamburg and Amsterdam, served to answer the immediate demands of the state; and orders were transmitted to these places, to draw for the reimbursements on London, Madrid, or Cadiz, according as the course of exchange was most favorable. The proceedings were all conducted with judgment, and attended with complete success."

97. We have now to treat of a cause of the movement of bullion which has acquired an importance in modern times, far exceeding what it ever did before, in fact, it is now probably more important than any other, viz., a difference in the rate of interest or discount between two countries. In former times when the communication between different places was slow and expensive, before the days of railroads and steamers, a considerable difference might exist in the rates of interest in two places, without causing a movement of bullion from one place to the other. But that is not possible now. The communication between places is so rapid now that directly the difference between the rates of interest in any two places is more than sufficient to pay for the expense of sending the bullion, an immediate flow of bullion commences from one place to the other. And this is in exact accordance with the usual mercantile principle that operates in every other case, that if the difference of price of the same article in any two markets is more than sufficient to repay the cost of sending it from one to the other, it will be sent; and this movement will continue as long as the difference in price continues. Now, if the rate of discount in London is 4 per cent. and that in Paris is 6 per cent. the simple meaning of that is that gold may be bought for 4 per cent. in London, and sold at 6 per cent. in Paris. But the expense of sending it from one to the other does not exceed $\frac{1}{2}$ or $\frac{3}{4}$ per cent., consequently it leaves $1\frac{1}{4}$ or $1\frac{1}{2}$ per cent. profit on the operation. The natural consequence immediately follows, gold flies from London to Paris, and the drain will not cease until the rates of discount are

equalized. It used to be the common delusion of mercantile men that gold was only sent to pay a balance arising from the sale of goods, and that therefore it must cease of itself whenever these payments were made. But this is a profound delusion. When the rates of discount differ so much as is supposed above between London and Paris, persons in London fabricate bills upon their correspondents in Paris for the express purpose of selling them in London for cash, which they then remit to Paris, and which they can sell again for 6 per cent. And it is quite evident that this drain will not cease so long as the difference in the rates of discount is maintained. Moreover, merchants in Paris immediately send over their bills to be discounted in London, and of course have the cash remitted them. Now, the only way of arresting such a drain is to equalize the rates of discount of the two places. These simple facts are a perfectly conclusive answer to those writers, and they are many, who complain of the variations of the rate of discount by the Bank of England, and suppose that it is possible to maintain a uniform rate. Consequently, at the present day it is the imperative duty of the Bank of England to keep a steady watch upon the rates of discount of neighbouring countries, and to follow these variations so as to prevent its being profitable to export bullion from this country.

98. As an immediate consequence of the preceding principles, it follows that a political or monetary convulsion in any country will immediately turn the foreign exchanges in favor of that country, if such an event is not prevented by the issue of an inconvertible paper currency. The reason is plain, any political or monetary convulsion is attended by a great destruction of *credit*. Now, that credit while it existed performed the functions of money, but as soon as it is destroyed there is an intense demand for money to fill the void. Money rises enormously in value. Multitudes of persons are obliged to sell their goods at a sacrifice. The con-

sequence is that money having risen greatly in value, both with respect to goods and debts, an immense quantity will flow in from neighbouring countries. Thus, in 1801-2 there was a great commercial crisis at Hamburg. The rate of discount rose to 15 per cent. That immediately drained the bullion from the Bank of England. In 1825, there was a great commercial crisis in England. For a considerable period the bank, by making extravagant issues at a low rate of discount, had turned the foreign exchanges against the country. But no sooner did the crisis occur in December than the foreign exchanges immediately turned in favor of it. Exactly the same thing happened in 1847. No sooner had the crisis in that year fairly set in than the exchanges turned in favor of the country. In the French revolution in 1793, and subsequent years, immense quantities of inconvertible paper were issued, that kept all the French exchanges in a very depressed state. In 1796, this paper currency was annihilated, and the exchanges immediately turned in favor of France. The same thing was observed in 1848. Things were to be had so cheap then that multitudes of persons went over to buy.

99. The simplest way of stating the subject of the exchanges, is, that the figures at the different markets denote the value of the same sum of money at each of them. Or what must be paid at one to place such a sum at the other. Thus, for instance, if the state of the exchanges were, for example, 25 at London and 22 at Paris, it would mean that the same sum of money was worth 25 francs in London, and 22 francs in Paris; just as a quarter of wheat may be worth 45s. at one market, and 40s. at another. In such a state the exchange would be against Paris, and it would manifestly be a great loss to transport bullion from London to Paris, but a profit to do the reverse, just the same as it would be a great loss to transport wheat from a market where it was worth 45s., to one where it was worth only 40s. While the exchanges between London and Paris were in such a state,

the Revolutionary government conceived the sapient project of ruining the British government, by buying up all the bullion in England. This was as wise as if a man were to try to ruin his enemy by buying up all his money at the rate of 21s. in the pound. It is not very difficult to see who would be ruined first. Sir Francis Baring exposes the folly of the French government with keen severity. But the English government outdid the French if possible in folly, for it did every thing it could to prevent this; that is, it refused to sell its pounds for 21s. each. Sir Francis well points out that the British government should have done everything to facilitate such operations.

100. The term *par of exchange* is also used in another sense, than the one we have already described, as applied to the exchange of one currency for another. When goods are sent from one place to another, the freight or carriage of them is charged in money, which is always added to their price; but when bankers remit money, the charge is made by keeping it a certain number of days in their hands, during which they enjoy the interest of it, or if the money is to be paid immediately at the place it is remitted to, the interest of it at the market rate for a fixed number of days is deducted. The number of days between two places has been fixed by long custom, and is called the *par of exchange* between them. Thus, if a person pays in a sum of money into a bank in Edinburgh, and wishes to receive a bill payable in London, the Edinburgh banker will give him a bill on his London agent, for the amount payable twenty days after date, and the interest of the sum for that time, and also three days of grace, defrays the banker's charges for sending the money from Edinburgh to London; or if the transmitter wishes to have a bill payable at sight in London, the Edinburgh banker will deduct the interest at the market rate for twenty three days, and give him a bill for the remainder payable at sight. These twenty days are called the *par of exchange* between London and Edinburgh. They are also called the *usance*.

101. The different dates forming the *par of exchange* or *usance*, between different places, have grown up by custom, and were of course settled long before the modern improvements in the speed and safety of locomotion, and they certainly seem excessive at the present day. Until the year 1825 the *usance* or *par of exchange* between Edinburgh and London was fifty days. In that year an Edinburgh banker offered to transmit money to London at a *usance* of twenty days, and the other banks were obliged to follow his example. But in the present time, when several express trains run daily from one city to the other in less than twelve hours, and the cost and danger of transmission is so much reduced, a *usance* of twenty days seems somewhat excessive. A *usance* of ten days would probably be sufficient to cover all risks and charges, and leave a profit besides. And the same observation applies to most foreign cities as well.

102. We have seen that whenever English merchants have payments to make to their correspondents, they will always endeavour to discharge their debts by remitting goods instead of specie, if the state of the home and foreign markets will permit them. It is, therefore, of the utmost importance to the country that its manufactures should be the cheapest and best possible, and that they should be produced in the greatest possible variety; as the greater the variety, the more will the merchant's chances be multiplied of being able to avoid the necessity of paying in bullion. But as there are a multitude of commodities, both natural and manufactured, which are not capable of being produced in this climate, it is evidently a most desirable object to make this country the great entrepôt for the productions of foreign commodities, so that not only may the English public be supplied with any article they require at the shortest notice, but the English merchants may have the greatest number of opportunities of paying their debts in commodities, rather than in money, by exporting these foreign productions.

103. The revenue of this country, as well as every other, has always been greatly if not chiefly raised by duties levied on all foreign imports. This duty used formerly to be levied on the merchant at the time of the importation of the goods, so that he had to advance money for duties long before he could reimburse himself from his customers. This, of course, led to great monopolies, as only the rich merchant could afford to advance these duties at once, and they required to increase the price of the article to the consumers to repay themselves for the loss of capital and interest. Not only was the article made dearer on this account, but it diminished importation very much, and so made foreign commodities much scarcer than they would otherwise have been. And all these causes encouraged smuggling, adulteration, and frauds of all sorts. In the year 1732, Sir Robert Walpole brought forward a scheme by which tobacco and wine might be deposited in public warehouses by the importers, under proper security, until wanted for home consumption, when the duty should be paid; and if they were exported, then they should be free of duty. The immense advantages of this plan were evident. By having the various products of foreign countries brought here, and kept in security at a small warehouse rent, it would have caused foreigners to resort to this country to supply themselves with all sorts of commodities, and it would have afforded the English merchants a much greater variety of productions at their command, to select for payment of their bills. This, however, was the chief feature of Sir Robert Walpole's famous excise scheme; and by the dishonest clamors of persons who were interested in maintaining the abuses and knaveries of the old system, the nation was driven into such a state of senseless phrenzy, that it nearly caused a rebellion, and was obliged to be abandoned, and was never brought forward again till 1803, when the first act for establishing a warehouse system was passed.

104. The immense advantage of the warehousing

system in preventing the export of specie is apparent. But it also operates with equal efficacy in causing the import of specie, as whenever commodities are scarce and dear in other markets, foreign merchants know that they have only to come and buy them in England. By this admirable system this country is made the market of the whole world.

105. From the considerations detailed in the foregoing chapter, we see upon how many complicated circumstances the ebb and flow of bullion depends, and how necessary it is to consider the causes which influence its transmission, before we can pronounce whether it is advantageous or the reverse to the country. We see what an utter fallacy the old notion is, that an influx of bullion is in itself, and without reference to its determining causes, a sign of prosperity. There is one conclusion which may be received with the greatest confidence,—that when it is caused by the unnatural restrictions upon trade, and by the arbitrary interference of laws with men's natural instinct to trade in the way most conducive to their own interests, it is decidedly the least advantageous article of commerce. We see that we can no more assume that trade is profitable to us because specie is remitted to this country, than we can assume that money payments are necessarily profitable to the tradesman or manufacturer. On this subject, as it will be found, as well as on every other commercial subject, we seem to have exhausted every modification of folly and absurdity, before we finally arrived at the simple and cardinal rule which the French merchants announced to Colbert more than a century and a half ago—"LET THINGS ALONE," and the belief that men have generally the intelligence to discover and act for their own interests, far better than any government can do for them.

106. We must now consider what the effect of an inconvertible paper currency will be on the foreign exchanges, and the market price of bullion. So long as paper is convertible, that is, the holder of it has the power

to demand payment in gold for it at sight, it is very clear that it cannot circulate at a discount, because if it fell to a discount every person who held it would immediately go and demand gold for it. But if while it enjoys considerable circulation, the power of convertibility is suddenly taken away, then it becomes in all respects equivalent to a new standard just as much as gold or silver, and its value will be affected by the same principles as these two, viz., by the sole question of the *quantity* of it in circulation compared to the operations it represents.

107. Under the old system of making an attempt to fix the value of silver and gold relatively to each other, there was no power of convertibility of one into the other similar to the convertibility of the note. If silver fell to a discount, as compared with gold, no persons could demand as a right to have their silver exchanged for gold, consequently the inevitable result of a considerable change in the quantity of either metal was a change in their market values. Thus, in 1794 gold rose to 84s. if purchased with *silver* bullion; now, if, speaking by analogy, the silver coin had been convertible into gold, the difference never could have arisen, any more than a bank note convertible at the will of the holder of it could circulate at a discount. Now, paper, when issued as a substantive standard of value, follows exactly the same rules; if only the usual quantity of it be issued, i. e., no greater quantity than would have been issued if it were convertible into specie, it will continue to circulate at its par value; but if these issues be continued, and if it be deprived of the natural corrector of an over-issue, viz., payment on demand, it is maintained in circulation, and exactly the same result follows as attends an excessive issue of silver,—it falls to a discount. Now, the silver, coin may fall to a discount from two circumstances, either if silver be coined with too great profuseness the excessive quantity of it will *diminish its value*, even though the coin be of full weight; or, if the silver coin be suffered to fall into a degraded state by clipping and wearing,

so that it does not contain the full legal weight of bullion, it then becomes *depreciated*. The apparent result in figures will be just the same in either case, guineas will rise to 24s. or 30s. But as silver has an intrinsic value of its own, and is, from its qualities, a recognised measure of value, it is not correct to apply the term *depreciation* to it as long as the coin contains its full legal weight of bullion. But the case is different with paper; it is only received on account of bearing a promise to pay a certain quantity of bullion on the face of it, and if it is not able to fulfil that promise, it is *depreciated*.

108. It is evident that a *diminution in value* of the coin cannot be followed by any difference between the market and the mint price of bullion. By the meaning of the words "mint price," however plentiful or however scarce gold may be, an ounce of it in coin must always be equal in value to an ounce of it in bullion. On the other hand, a *depreciation* of the coinage must inevitably be attended by a rise in the market price above the mint price of bullion, because, however plentiful or scarce gold is, three-quarters-of-an-ounce of it in coin can never be equal in value to one ounce of it in bullion. Or we may state it shortly thus—Guineas may rise to 25s. either from depreciation, or from the diminution in value of silver; either because the silver coinage is depreciated, or because it is super-abundant. What is the test? It is the mint price. If the coinage is debased, the market price of silver will rise above the mint price, if it is diminished in value it will not.

109. Now, as the paper currency has no intrinsic value of its own, and is a mere parasitical growth upon the metallic currency, it is clear that it is an inaccurate term to apply the expression *diminution in value* to it at all. One absolute *nothing* cannot diminish in value. The only accurate word to apply to it is DEPRECIATION. Twenty shillings in silver do not profess to be able to command any quantity of gold; but a bank note professes to be able to command a certain quantity of gold, and if it cannot fulfil its promise it is *depreciated*.

110. Now, if for the public convenience it be deemed advisable to issue an inconvertible paper currency, the only way of maintaining its currency at par is by limiting its quantity. We do not mean by this, limiting its quantity to an absolute fixed amount, but by devising some means whereby *a greater quantity of it shall not be issued than if it were convertible into gold*. If more than this be issued, it will be followed by the same result as attends an excessive issue of silver, it will fall to a discount, which in this case is *depreciation*, and the necessary consequences of a depreciated currency will follow, viz., the market price (or paper price) of bullion will rise above the mint price, and the foreign exchanges will fall.

111. Now, if such a state of things happens, the proper remedy is to *diminish* the quantity of the paper in circulation until the market price of bullion is reduced to the level of the mint price. If the direct power of demanding five sovereigns be taken away from the holder of a £5 note, still, if he can purchase bullion with it in the market to the amount of five sovereigns, it is an infallible proof that the note is current at par; and the limitation need not proceed beyond that. But if this be not done, the next best thing is to allow all persons to receive the notes at whatever value they choose to put upon them, and let them make a difference, if they choose, between the prices of articles when paid in gold, or in paper. If this be allowed, no very great inconvenience will take place in the internal trade of the country beyond a certain loss of *prestige* which must happen to an institution whose paper circulates at a discount.

112. But suppose the law, with more zeal for the honor of the paper currency than discretion, declares it to be a crime to make a difference between paper and gold, and a punishable offence to give twenty sovereigns in gold for twenty-one pounds in paper—what will be the consequence? Exactly the same as we have seen

happened, when the silver and gold coins were improperly rated, *the one which was underrated disappeared from circulation*. We have seen this happen both in the case of the gold coin and the silver coin. Now, when the inconvertible paper currency is issued in too great abundance, and has a tendency to overflow the channels of circulation, its natural effect is to raise prices when paid in it. If people were free in their transactions, they would gradually make a difference in price between payments in paper and payments in bullion; but if the owners of the coin are prevented by law from receiving more for it, than the same nominal sum in paper, they will do exactly the same thing, as is invariably done when in a metallic currency, part is depreciated and part is of full weight, —they will either hoard or export it. At all events it will disappear from circulation. Now, as the gold gradually disappears, and paper issues multiply, people begin to estimate all prices by transferring their ideas from the gold to the paper, and the paper ends by finally displacing the entire gold coinage.

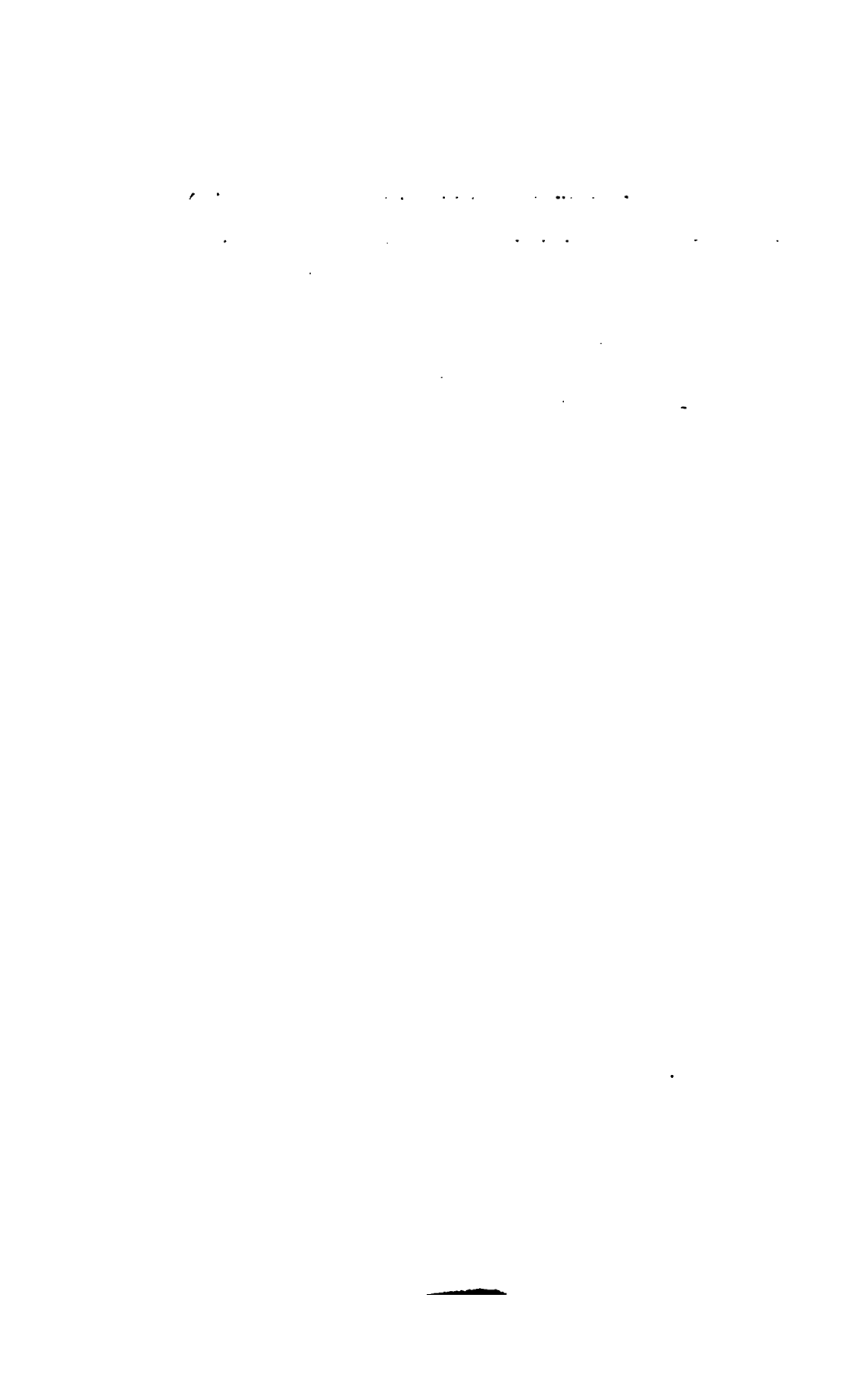
113. The stamp on the coin is similar to the banker's "promise to pay" on a note. The stamp is the guarantee of the State that the coin does actually contain a given amount of bullion; the "promise to pay" is the banker's guarantee that he can pay so much coin if required. The convertibility of the coin into the legal amount of bullion is the test of the depreciation of the metallic currency; so the convertibility of the note into coin is the test of the depreciation of the note. If the power of demanding coin be taken away by the State, the power of commanding a certain quantity of bullion in the market still equally remains as the only test of its value. The *Mint* price of bullion is the price paid in coins of the full legal weight, the *market* price means its price paid in the current coins, and a difference between the two is the proof and measure of the depreciation of the current coin. When paper became the standard currency, the market price of bullion meant the price of

it when paid in the paper currency, or the paper price of it; and by a parity of reasoning, if the paper price of gold bullion rose above the Mint price, it was the *proof and the measure of the depreciation of the paper currency.*

114. Whenever the currency of a country becomes redundant, that is to say, that prices rise so much higher in one country than in its neighbours, that the value of money sensibly diminishes, the natural corrective for such a thing is to take a certain portion of it out of circulation, so that by diminishing the quantity of it, its value may be raised. When people find that the same quantity of gold will not purchase an equal amount of commodities in this country as they will in another, their own natural instincts will lead them to purchase commodities abroad where they are cheap, and bring them for sale here where they are dear. The natural instincts of trade will, therefore, produce an equilibrium in value in the currency of neighbouring countries.

115. Now when the currency of a country consists partly of paper and partly of gold and silver, it is quite clear that only the metallic portion of it can be exported in payment of foreign commodities. The paper portion of it which has no value abroad, must remain at home. If the issues of the paper be continued, so as to prevent the currency from recovering its value, the process of the exportation of the metallic portion will go on until it is entirely exhausted. If this be the case, the only method of restoring the currency to its former value is by diminishing the quantity of the paper, until the drain is stopped by the enhancement of the value of the whole currency. There is, however, a School of Doctrines that maintains that as the gold goes out, paper should be issued to supply the vacuum until the gold comes back. But it requires little sagacity to see that if that be done, *the gold never will come back again*, and the drain will not cease until it is totally exhausted, and the only way to bring it back again is to raise its value at home, which can be done only by removing the plethora of paper.

When the currency is in its healthy state, the oscillations of the exchange may be compared to those of a tight, staunch ship, which has always a natural tendency to recover itself; but when there is an excessive quantity of paper, it is like the same ship waterlogged, when she once heels over she never can recover herself until the water is pumped out.



CHAPTER V.

ON SOME THEORIES OF CURRENCY.

“On subjects concerning which speculative minds are still divided, a writer does but half his duty by stating his own doctrines, if he does not also examine, and to the best of his ability, judge those of other thinkers.”

J. S. MILL. *System of Logic*. 4th Edit. Vol. I, p. 292.

CHAPTER V.

ON SOME THEORIES OF CURRENCY.

EXPLANATION OF JOHN LAW'S THEORY OF MONEY AND ITS FUNDAMENTAL FALLACY.—ALL ATTEMPTS TO REDUCE LAW'S THEORY OF MONEY TO PRACTICE MUST NECESSARILY TERMINATE IN RUIN—ALL THEORIES OF CURRENCY WHICH ATTEMPT TO FOUND A CIRCULATING MEDIUM UPON COMMODITIES, ARE FORMS OF LAWISM.—CAPITAL IS THE ONLY TRUE BASIS OF A CIRCULATING MEDIUM—CAPITAL AND CREDIT, PRESERVING AN EQUALITY OF VALUE WITH CAPITAL, ARE ITS ONLY TRUE LIMITS—FALLACY OF THE BANK THEORY OF REGULATING THE PAPER CURRENCY BY THE DISCOUNT OF MERCANTILE BILLS—THE RATE OF DISCOUNT IS THE ONLY TRUE METHOD OF REGULATING THE PAPER CURRENCY—FALLACY OF A PREVALENT DOCTRINE OF PAPER ISSUES.

1. It now becomes our essential and most important duty to investigate some theories of currency, which have acquired great celebrity, not only from their historical interest as having led to some of the most extraordinary and heartrending public calamities on record, but because they are still extensively believed in at the present day. It is of essential importance, not only to lay the true foundations of monetary science, but also to point out the fundamental fallacies upon which some specious, but fatally delusive theories rest, which have brought the most disastrous consequences upon those nations which have adopted them, as will always be the case when the eternal laws of nature are systematically and perseveringly violated.

2. The first of these theories we shall designate as **LAWISM**, not because John Law was the original deviser of it, but because he was the first who wrote the most formal treatise on it, and he had the opportunity of carrying it out on the most extensive scale. His name, therefore, must always be most prominently associated with it; and it is one so specious, but so dangerous and so widely prevalent at the present time, that it requires to be branded with a distinctive name, and to be combated with all the power of argument that can be brought against it.

3. The question shortly stated is this. All persons except those who advocate an inconvertible paper currency, agree that a paper currency must represent some article of value, and bullion has been generally chosen for that purpose. Now, the idea has occurred to a great many persons—If it is only necessary that a paper currency should represent some article of value, why should it not represent any or all articles of value, such as land, corn, silk, or any other commodities, and, among others, the public funds? And this has actually been tried in several instances, yet they have universally failed, and in many cases have been attended with the most dreadful calamities. Now, as this has uniformly happened, and, as we shall shew further on, it must happen, it necessarily follows that there must be some radical error in the principle, and that it must violate some great law of nature. And this is beyond all comparison the most momentous problem in Political Economy—Why is it improper to issue a paper currency on any other basis than that of bullion? All the most eminent British Statesmen have instinctively resisted such proposals, although repeatedly pressed to do so. No doubt it has been a most fortunate instinct for the country, but all their reasonings on the subject, if only pursued to their legitimate consequences, tend to that result. The Bank Act of 1844 was the first occasion on which a small bit of this theory was introduced, which if only followed out

to its legitimate conclusion, would reproduce in this country the horrors of the Mississippi scheme in France. But though the British parliament by a blind, unreasoning instinct has always, with the exception just named, resisted such fatal advice, this will not satisfy the demands of science. Science imperatively demands a reason *why* such a plan is wrong; she will not be satisfied with a simple dogmatic assertion that it is wrong, even though that dogma may be right, but she must know the reason why, and until a true scientific reason is given why such plans are fatal, there will be a constant demand for them.

4. It is, moreover, the thing which has brought the name of Law into such unhappy notoriety. Law has in many respects very great merit as a writer. In many respects he had clearer and sounder views on monetary science, he had infinitely more practical insight and scientific knowledge of what he was writing about, than the most eminent of modern political economists. In his various writings is to be found the refutation of all the absurd follies of the government and of the Bank of England in 1811. But all this was marred by a single defect. He was the great advocate of what is now the popular cry—basing a paper currency upon any article of value besides bullion. The only difference between him and our greatest statesmen is that he carried out their arguments to their legitimate conclusion. He had the opportunity of carrying this theory into effect, and the result has been to obscure all his other merits, and brand him for ever as a charlatan. What, then, was his error?

5. Upon sifting his theory to discover his error, we shall obtain one of the most beautiful triumphs of pure reasoning to be found in any science. We shall find that the plausible scheme which we shall designate by his name, is founded upon a direct contravention of the fundamental conception of the nature of a currency which we have established in this volume, and the pro-

position which directly flowed from it, viz., *that where there is no debt, there can be no currency.* We shall find that these awful monetary cataclysms which have shaken nations to their foundations, producing calamities more fell than famine, tempest, or the sword, have been brought about by attempting to carry into practice a philosophical fallacy which involves a contradiction in terms.

6. It is impossible to say who first invented the theory we are going to notice; in fact, it must have sprung up indigenously among almost any people who began to form theories of paper currency. Several persons about the same time seem to have hit upon it. The earliest we know of was a certain Mr. Asgill, a member of parliament, who paid much attention to commercial questions. The most notorious precursors of Law were Dr. Hugh Chamberlain, who brought forward a rival scheme to the Bank of England in 1693, and Mr. Briscoe, one of the chief promoters of the Land Bank in 1696. Chamberlain's ideas will be noticed a little further on. He strongly accused Law of having stolen his ideas from him, which Law strenuously repudiates, and points out the distinction between them, and it must be allowed that Law's ideas were not so extravagant as Chamberlain's. Law first published his theory in a tract, called "*Money and Trade considered,*" at Edinburgh, in 1705. He was the son of a goldsmith, and of dissipated habits, but of an extremely acute intellect; and up to a certain length, his views are sagacious and correct—much more so, indeed, than those of many writers at the present day. He observed the extreme poverty and barbarousness of Scotland, which he thought might be cured by bringing an additional quantity of money into the country; and as silver was scarce, he attempted to devise a scheme for providing a substitute for it.

7. He begins by many very sound and acute remarks on the value of commodities, and the causes of their change of value. He describes the qualities which fitted silver to be used as money, above every other commodity.

He attributes the very inconsiderable trade of Scotland to the small quantity of money she possessed.* This is the first fundamental fallacy, because the fact was, it was just the reverse; Scotland had little money *because* she had little trade. He, however, perceived the fallacy of lowering interest by law. He then goes on to consider the various means which have been employed to increase the quantity of money. He says that some countries have raised money in the denomination; some have debased it; some have prohibited its export under the severest penalties; some have obliged traders to bring home bullion in proportion to the goods they imported. But he says that all these measures have been futile and vain, and none of them have been found to increase, or preserve money.† He then says, that the only effectual method hitherto discovered for the increase of money, was the erection of banks. He then describes various banks. Some made it a principle to issue no more notes than they had of actual bullion. He then mentions the Bank of England, and the superiority of its notes over those of the goldsmiths. He then describes the Bank of Scotland, and says that it issued notes to four or five times the value of the money in the Bank, which he very justly says were equivalent to so much additional money. He then points out the absurdity of supposing that raising the denomination of the money, added to its value: that if the shilling was raised to 18d., it paid debts by two-thirds of what was due, but did not add to the money; "for it is not the sound of the denomination, but the value of the silver is considered." The wonderful philosophers of 1811, no doubt, looked down with prodigious disdain upon Law, but they might have studied him with advantage. He then points out with much detail the fraud and inutility of tampering with the currency. He describes the additional effect which credit may give to money; but says that credit which promises a payment

* Money and Trade considered. p. 34. Edit 1750.

† Ibid. p. 63.

of money, cannot well be extended beyond a certain proportion it ought to have with the money. Nothing can be more judicious and sound than his remarks upon credit—that it must always vary in proportion to the metallic basis it is built upon; and up to this point, his sagacity and penetration are in advance of the doctrines of a century later; but here is the boundary, after which he plunges into that fatal and delusive fallacy which is the distinctive feature of what we denominate **LAWISM**.

8. Thinking that money was so scarce in Scotland, that any credit that could be built upon it would be insignificant, he says:

“It remains to be considered, whether any other goods than silver can be made money with the same safety and convenience.

“From what has been said about the nature of money, it is evident that *any other goods which have the qualities necessary in money*, MAY BE MADE MONEY EQUAL TO THEIR VALUE with safety and convenience. There was nothing of humor or fancy in making silver to be money; it was made money because it was thought best qualified for that use.

“I shall endeavour to prove that another money may be established, with all the qualities necessary in money, in a greater degree than silver.”

9. He then proceeds to show at great length that silver had some peculiarities that disqualified it from being the best substance to form money of; that it varied in value; that it had increased much faster in quantity than the demand for it, and had, therefore, fallen much in value. In fact, he tries to prove that silver had varied in value more than any other kind of goods, within the last two hundred years; that goods would always maintain a uniformity of value, because they only increased in proportion to the demand; that land would always rise in value, because the quantity would always remain the same, but the demand would continually increase; but that silver would always fall in value, as the quantity increased faster than the demand.

10. Law then proceeds to deny that he had taken his ideas from Chamberlain, of which the latter had

accused him; and it must in candor be admitted, that his ideas were many degrees less mad than those of Chamberlain. Law asserts that he had formed his schemes many years before he had seen any of Chamberlain's papers.* "Land, indeed, is the value upon which he founds his proposal, and 'tis upon land that I found mine; if for that reason I have encroached upon his proposal, the Bank of Scotland may be said to have done the same. There were banks in Europe long before the doctor's proposal, and books have been written on the subject before and since. The foundation I go upon has been known so long as money has been lent on land, and so long as an heritable bond has been equal to a quantity of land."

11. The difference between Chamberlain's theory and Law's was this. Chamberlain maintained that if land was mortgaged for 100 years, it was a good security for 100 times its annual value; so that if a man had landed property worth £1,000 a-year, and if he mortgaged it for 100 years to the State, the State might issue notes to him to the amount of £100,000, which were to be declared equal in value to silver, and made legal tender for their nominal value. Now, if this theory be true, there is no good reason why land should be pledged for only 100 years; why not for one million years? which would do the thing on a somewhat more magnificent scale. But what need of stopping there? Why not pledge it to all eternity? And then every inch of the property might be covered with paper notes, and they might be piled high enough to reach the Moon, where the deviser of this scheme would probably find his lost wits. Law properly points out that the fallacy of this theory was, that Chamberlain assumed that the value of £100 to be paid 100 years hence is still £100. He says, "No anticipation is equal to what already is, a year's rent now is worth fifteen year's rent fifty years hence, because that money lent out at interest by

* Money and Trade Considered. p. 153.

that time will produce so much." But says Lord Macaulay,* "On this subject Chamberlain was proof to ridicule, to argument, even to arithmetical demonstration. He was reminded that the fee simple of land would not sell for more than twenty years' purchase. To say, therefore, that a term of 100 years was worth five times as much as a term of twenty years, was to say that a term of 100 years was worth five times the fee simple; in other words, that 100 was five times infinity. Those who reasoned thus were refuted by being told they were usurers; and it should seem that a large number of country gentlemen thought the refutation complete."

12. Law's theory was to calculate the value of the fee-simple of the land at twenty years' purchase and to coin notes to the value of that amount, and advance them to the owner of the land. This plan, therefore, had a limit, however absurd it was. It was bounded in the first instance by the value of the land expressed in silver money, but Chamberlain's had positively no limit at all to carry it out to its full length; the advance might be made to infinity, consequently, in mathematical language we should say that Chamberlain was *infinitely* more mad than Law.

13. Law shewed that notes issued upon Chamberlain's plan would immediately fall to a heavy discount; but yet he says, that though £500 of these notes were only equal to £100 in silver, yet the nation would have the same advantage by that £500 in notes as if an addition of £100 had been made to the silver money.

"So far as these bills fell under the value of the silver money, so far would exchange with other countries be raised.† And if goods did not keep their price, i. e., if they did not sell for a greater

* Hist. of England. Vol. iv. p. 496.

† This is the first occasion that we are aware of, on which the great principle, that a depreciation of the paper currency would produce a fall in the foreign exchanges, which was so ardently contested in 1811, and subsequent years, is asserted. And it has all the more merit that it is a *prediction*, and not an *observation*.

quantity of these bills equal to the difference betwixt them and silver, goods exported would be undervalued, and goods imported would be overvalued.

"The landed man would have no advantage by this proposal *unless he owed debt*, for though he received £50 of these bills for the same quantity of victual, he was in use to receive £10 silver money; yet that £50 would only be equal in value to £10 of silver, and purchase only the same quantity of home or foreign goods.

"The landed man who had his rent paid him in money, would be a great loser, for by as much as these bills were under the value of silver, he would receive so much less than before.

"The landed man who owed debt, would pay his debt with a less value than was contracted for, but the creditor would lose what the debtor gained.*

Oh! that the philosophers of 1811 had only pondered over this extract from John Law!

14. Law then shews that,

"Notwithstanding any Act of Parliament to force these bills, they would fall much under the value of silver; but allowing that they were at first equal to silver, it is next to impossible that two different species of money shall continue equal in value to one another.

"Everything receives a value from its use, and the value is rated according to its quality, quantity, and demand. Though goods of different kinds are equal in value now, yet they will change their value from any unequal change in their quality, quantity, or demand.

"And as he leaves it to the choice of the debtor to pay in silver money, or bills, he confines the value of the bills to the value of the silver money, but cannot confine the value of the silver money to the value of the bills, so that these bills must fall in value as silver money falls, and may fall lower, may rise above the value of these bills, but these bills cannot rise above the value of silver."

15. Law succeeds with great skill and acumen in exposing the wild insanity of Chamberlain's plan, and truly predicts the results which would follow from it, or, at least some of them, for there are many important ones he has omitted. The exact consequences which he predicted were manifested in Ireland and England a century later, and the sentences we have quoted, if we

* Money and Trade Considered. p. 151.

did not know their origin, might have been supposed to have been written to rebuke the folly of the directors of the banks of Ireland and England, and the mercantile witnesses of 1804 and 1810. But having demolished Chamberlain, he comes to his own proposal, which he says is "to make money of land equal to its value, *and that money to be equal in value to silver money, and not liable to fall in value as silver money falls.*" He then says, "ANY GOODS THAT HAVE THE QUALITIES NECESSARY IN MONEY, MAY BE MADE MONEY EQUAL TO THEIR VALUE. Five ounces of gold is equal in value to £20, and may be made money to that value; an acre of land, rented at two bolls of victual, the victual at £8, and land at twenty years' purchase, is equal to £20, and may be made money equal to that value, for it has all the qualities necessary in money."

16. In this sentence is concentrated the whole essence of that eternal delusion, so specious and plausible, and so fatal, which we designate as LAWISM. It is indeed nothing but the stupendous fallacy *that money represents commodities, and that paper currency may be based upon commodities.* This delusion is deeply prevalent in the public mind at the present day, and probably there are few persons except those who have studied the true philosophical principles of Political Economy whose views are not deeply tainted with this infection. No man who does not thoroughly understand the great fundamental doctrine established by Turgot and others, that money does not represent commodities, can ever have sound ideas on this subject. MONEY DOES NOT REPRESENT COMMODITIES AT ALL, BUT ONLY CAPITAL, THE ACCUMULATION OF LABOR WHICH HAS NOT YET BEEN GIVEN FOR COMMODITIES. Now, the views of Law are much more extensively prevalent than is generally supposed. All those who think that there is any necessary connection between the quantity of money in a country and the quantity of commodities in it are influenced by them. Take the case of a private individu-

al. Is there any necessary relation between the quantity of money he retains and the quantity of commodities he purchases? The quantity of money he has, is just the quantity of capital—of services due to him—which he has *not yet* parted with for something else. It is the quantity of power of purchasing commodities he has over and above what he has already expended. And the quantity of money a nation possesses is simply the quantity of accumulated industry it possesses over and above all commodities, but they have no relation whatever to each other. Now, money does not represent commodities, but it represents this portion of a man's industry which is preserved for future use. Whatever a man earns is the fruit of his industry, money included; and none of these separate items *represents* anything else, though it may be *exchanged* for other things. Now, the value of money depends upon its relations to what it represents, namely debt or capital, and not to commodities. If money, or currency, increases faster than capital, it immediately causes a diminution of its value. If capital increases faster than money or currency, then the value of money is raised. The infallible consequence, therefore, of an increase of currency, without a corresponding increase of capital, is to change the existing proportion between capital and currency, and to cause a depreciation of the latter commensurate to the changed proportion. The necessary and inevitable consequence, then, of issuing vast quantities of paper currency on the assumed value of property, is simply to cause a total subversion of the foundation of all value and of all property, and to plunge every creditor into irretrievable ruin.

17. In fact, a moment's consideration will shew that the theory of basing a paper currency on commodities, involves this palpable contradiction in terms, THAT ONE CAN BUY COMMODITIES AND ALSO HAVE THE MONEY AS WELL. When a man buys commodities with money, he gives either a portion of his own industry represented

by that money, or a portion of some one else's industry who gave him the money. But it is quite clear *that he cannot buy the commodities and keep his money as well.* It is exactly the same with a nation. A nation cannot buy commodities and have the money it bought them with as well, which is the principle necessarily involved in issuing paper currency as the representative of commodities. But the money of the nation is the mode and form in which the accumulation of industry which has not yet been spent in commodities is preserved; and if a nation wants other commodities besides what it has got, it must pay for them either with money, or with the goods it has already. The idea of basing paper currency upon commodities is just as wild and absurd as if England were to sell her cotton goods to America for coin, and then demand back her cotton goods. The only result of such an attempt carried out into practice must be the most tremendous convulsions, and destruction of credit and all monetary contracts.

18. Law, as we have seen, immediately saw through it, and exposed the ridiculous absurdity of Chamberlain's proposal. His own was that the value of all the land in Scotland should be estimated at 20 years' purchase, and that a parliamentary commission should be appointed with power to issue an inconvertible paper currency to that amount. He says, "The paper money proposed will be equal in value to silver, for it will have a value in land pledged equal to the same sum of silver money that it is given out for. * * * This paper money will not fall in value, as silver money has fallen or may fall."

19. We must, therefore, be careful to be just to Law. He was no advocate of an unlimited inconvertible paper currency. Quite the reverse. But seeing that a convertible paper currency could only be based upon bullion to a certain limited extent, preserving its equality in value with bullion, his idea was to base a paper currency upon some other article of value. And he thought that it

might preserve its equality in value to silver, on an independent basis. His idea was, that it was only necessary to have it represent some article of value. But this attempt was contrary to the nature of things. His paper currency, though avowedly based upon things of value, had exactly the same practical effects as if it had been based upon silver. It became redundant, and swamped everything. And the reason is plain. It was a violation of that fundamental principle we have obtained*—"Where there is no debt there can be no currency." And the fresh quantities of currency issued on such a principle only represent the previously existing amount of debt, and then suffer a necessary diminution in value. The necessary and inevitable consequence, then, of issuing vast quantities of paper currency on the assumed value of property, is simply to cause a total subversion of the foundation of all value, and of all property, and to plunge every creditor into irretrievable ruin.

20. To give a full account of the banking career of Law in France, would exceed our limits, and an imperfect account would do little good; and there are so many other sources where ample details of it can be had, that we must content ourselves with referring to them. The next conspicuous example and catastrophe—for they are synonymous—of Lawism, was the Ayr Bank, in Scotland. We have stated elsewhere† that the Scotch banks had got themselves into a very perilous position by an undue expansion of credit, out of which they gradually worked themselves by stringent measures. Then, as now, schemers thought it was the duty of the banks to lend for as long a time, and to as great an extent, as they might wish to borrow,‡ and they were very indignant when the banks declined to act accordingly. In the midst of this clamor, a new bank was formed for the express purpose of accommodating the demands of every

* Chap. I. Section 14. † The. and Prac. of Banking. Chapter VII. § 87.

‡ Adam Smith. Wealth of Nations. Book II., Chap. 2.

one who wished to borrow, and especially of promoting agricultural improvement. The Duke of Hamilton and other great noblemen and landed proprietors, were the chief proprietors and promoters of it; and it was set up under the title of Douglas, Heron and Co., in Ayr. The estates of the proprietors were worth several millions, and because of this, they entertained the fatal delusion, that they might issue paper to any amount up to that value, without its being depreciated. Accordingly, Adam Smith says, that it made scarcely any distinction between real and accommodation bills, but discounted them both with indiscriminate profusion. "It was the avowed principle of this bank to advance upon any reasonable security, the whole capital which was to be employed in those improvements, of which the returns are most slow and distant, such as the improvements of land. To promote such improvements was even said to be the chief of the public spirited purposes for which it was instituted." We have seen it stated somewhere, that the bank was insolvent within a fortnight after it opened. This enormous increase of currency, compared to capital, had its inevitable effect; its notes began to diminish in value, from excessive abundance, and they were returned on it for payment. Their gold and silver was insufficient to meet the demand for exchanging the notes, and they adopted the plan of drawing upon London, and when the bill became due, paying it, together with interest and commission, by another draft upon the same place. The enormous and known wealth of its proprietors helped to sustain the credit of the notes for some time; but the bank was fairly in the Maelstrom, and at the end of two years, stopped payment, with liabilities amounting to £800,000. After several years, all the creditors were paid in full out of the assets of the shareholders. So terminated the second practical example of Lawism. Nevertheless, this experiment was not without its residuum of benefit. The greater part of the issues were made for the special purpose of promoting agricultural improvements,

and they were applied to that purpose, and the prodigious advance made by Ayrshire in agricultural improvements, dates from that time. It is not, therefore, that *all* advances for such purposes are to be condemned; but the fatal and radical vice of Lawism is, that it extends the limits to which such advances may be made, to a degree far beyond what is justified by the very nature of monetary science; and that as soon as this natural limit is passed, the paper suffers a rapid and unavoidable depreciation. No one saw more clearly than Law, that capital and credit must increase and decrease together; but what he failed to see was, that these paper issues were nothing but *credit*, although he was deluded into the idea that they were actual value.

21. The third great outburst of Lawism took place in the same country that witnessed his first exploits. In preparation for it, Law's "Money and Trade Considered" was translated into French in 1789, as if all the memory of the great catastrophe sixty-nine years before had perished. The National Assembly had confiscated the property of the Church, but instead of yielding a revenue, it cost the nation £2,000,000 a year more than it produced, and in a few years augmented the public debt by £7,000,000.* The property seized was valued at £80,000,000. The expense of the management required that it should be sold, but no purchasers could be found; for all persons in that terrible political earthquake wished to have their property in as portable a shape as possible, and few were willing to trust to a revolutionary title. In this dilemma, the municipalities agreed to purchase a considerable portion of it in the first instance, and resell it in smaller portions to individuals. But as there was not specie enough to complete the sale, they issued their promissory notes to the public creditor, to pass current until the time of payment came; but when they became due, the municipalities had no means of discharging them.

* Alison's Hist. of Europe. Vol. II. p. 147. 7th Edition.

To meet them, the Assembly, in the spring of 1790, authorized the issue of £16,000,000 of assignats on the security of the land. In September, further issues to the amount of £32,000,000 were authorised. These additional issues were warmly opposed by Talleyrand and other leaders, who predicted their depreciation; but Mirabeau strongly supported them, denying the possibility of their depreciation, saying:

“It is vain to assimilate assignats secured on the solid basis of these domains to an ordinary paper currency possessing a forced circulation. They represent real property, the most secure of all possessions, the land on which we tread. Why is a metallic circulation solid? Because it is based on subjects of real and durable value, as the land, which is directly or indirectly the source of all wealth. Paper money, we are told, will become superabundant; it will drive the metallic out of circulation. Of what paper do you speak? If of a paper without a solid basis, undoubtedly; if of one based on the firm foundation of landed property, never. There may be a difference in the value of circulation of different kinds; but that arises as frequently from the one which bears the higher value being run after, as from the one which stands the lower being shunned—from gold being in demand—not paper at a discount. There cannot be a greater error than the terrors so generally prevalent as to the over-issue of assignats. It is thus alone you will pay your debts, pay your troops, advance the revolution. Re-absorbed progressively, in the purchase of the national domains, this paper-money can never become redundant, any more than the humidity of the atmosphere can become excessive, which descends in rills, finds the rivers, and is at length lost in the mighty ocean.”

22. Although these assignats bore 4 per cent. interest, they had become depreciated in June, 1790; by June, 1791, they had lost one-third of their value. In September, 1792, further issues were decreed. The two preceding Assemblies had authorised assignats to the amount of 2,700,000,000 francs, equal to £130,000,000, to be fabricated, of which only 200,000,000 francs remained unspent. On the 11th of April, 1793, the Convention decreed six years' imprisonment in chains to any one who bought or sold assignats for any sum in specie different to their nominal value, or made any difference

between a money price and a paper price in payment of goods. Vain effort! In June the assignat had fallen to one-third of its value, and in August to one-sixth. The exchange with London fell exactly in a corresponding ratio with the depreciation of the assignat at home. In June, 1791, it fell to 23; in January, 1792, to 18; in March, 1793, to 14; in June, 1793, to 10; on the 2nd of August, it was as low as 4½; on the 18th of October, it had risen to 8; but after that, it ceased to be quoted at all.* Cambon, the Minister of Finance, proposed a further immediate issue of 800,000,000 of francs, equivalent to about £33,000,000, in addition to the quantity already issued. The public domains he calculated at £350,000,000. Hence, upon the Theory of Law and Mirabeau, there was an ample margin, and the assignats should not have been depreciated below the value of silver; and, in fact, according to them, it was impossible they should. Wonderful commentary upon the wisdom of the philosophers, who maintain that if a paper currency only represents *value*, it cannot be depreciated!

23. We must refrain from detailing the terrible misery caused by the forcible issues of assignats, which were legal tender at their nominal amount, the destruction of debts, the famine from the scarcity of provisions, the laws of the maximum, the penalty of death enacted against all who should keep back their produce from the market. All specie disappeared from the country and from circulation; those who possessed any deeming it not secure from revolutionary violence, exported it to London, Hamburg, Amsterdam, and Geneva. But many persons stoutly maintained, in pamphlets, that it was not the paper which was depreciated, but the specie which had risen.

24. The intolerable misery caused by this state of things caused the government which succeeded the Reign

* Report of Committee of Commons on Resumption of Cash Payments, 1819, p. 288.

of Terror to make an attempt to withdraw a portion of the assignats from circulation, by *demonetizing* them; that is, depriving them of their quality of money, and forcing their holders to receive payment in land for them. But when a man wanted to buy food to eat, what was the use of giving him land? The report that a portion of the assignats were going to be demonetized, sent down their value still lower, and a decree against it was obliged to be passed, to appease their holders.* All sorts of plans were devised to withdraw them from circulation; lotteries, tontines, a land bank, where they were to be lodged, and bear 3 per cent. interest. But the constant issue of them, required for the necessary payments of the State, rendered all such attempts useless.

25. In January, 1796, the assignats in circulation amounted to forty-five milliards, or about £2,000,000,000, and the paper money had fallen to one-thousandth part of its nominal value. The Government then determined to issue *territorial mandates* at the rate of 30 assignats to one mandate, which were to be exchangeable directly for land, at the will of the holder, on demand. The certainty of obtaining land for them made them rise for a short time to 80 per cent. of their nominal value; but necessity compelled the Government to issue £100,000,000 of these mandates secured upon land supposed to be of that value. This prodigious issue sent the mandates down to nearly the same discount as the assignats were, and consequently, as one mandate was equal to 30 assignats, the latter had fallen to nearly the thirty-thousandth part of their nominal value. At length, on the 16th of July, 1796, the whole system was demolished at a blow. A decree was published, that every one might transact business in the money he chose, and that the mandates should only be taken at their current value,† which should be published every day at the Treasury. Two

* Thiers. Hist. de la Revolution, Vol. vii., p. 255. Edit. 1832.

† Alison's Hist. of Europe, Vol. vi., p. 76. 7th Edition.

days afterwards, it was desired that the national property remaining undisposed of should be sold for mandates at their current value. As a matter of course, the public creditors received payment of their debts in the same proportion.

26. No sooner, however, was this great blow struck at the paper currency, of making it pass at its current value, than specie immediately re-appeared in circulation. Immense hoards came forth from their hiding places; goods and commodities of all sorts being very cheap from the anxiety of their owners to possess money, caused immense sums to be imported from foreign countries. The exchanges immediately turned in favor of France, and in a short time, a metallic currency was permanently restored. And during all the terrific wars of Napoleon, the metallic standard was always maintained at its full value.

27. One thing, however, we cannot help noticing. When describing the history and effects of the assignats, nothing can be more clear and correct than the narrative of Sir Archibald Alison. He sees clearly that a difference in value between the assignat and specie was truly a discount, or fall in the value of the paper. Thus, he says:*

"They for some time maintained their value on a par with the metallic currency. By degrees, however, the increasing issue of paper produced its usual effects on public credit; the value of money fell, while that of every other article rose in a high proportion, and at length the excessive inundation of fictitious currency caused a universal panic, and its value rapidly sank to a merely nominal ratio. Even in June, 1790, the depreciation had become so considerable, as to excite serious panic."

Again, speaking of 1791: †

"Public and private credit had alike perished amidst the general convulsions. Specie had disappeared from circulation. The assignat had *fallen* to a third of its value, ‡ and occasioned such

* Hist. of Europe, Vol. II., p. 219. 7th Edit. † Ibid., p. 305.

‡ This is not quite correct. At this time the assignat had lost one-third of its value, not fallen to one-third of it.

an amount of ruin to private fortunes, that numbers already wished for a return to the ancient regime.

"While the unlimited issues of assignats, at whatever *rate of discount* they might pass, amply provided for all the present and probable wants of the treasury.*

"The vast and increasing expenditure of the Republic could only, amidst the total failure of the taxes, be supplied by the issue of assignats; and this of course, by rendering paper money redundant, lowered its value in exchange with other commodities, and occasioned a constant and even frightful rise of prices.†

"All the persons employed by Government, both in the civil and military departments, were paid in the paper currency at par; but as it rapidly fell, from the enormous quantity in circulation, to a tenth-part, and soon a twentieth of its real value, the pay received was merely nominal, and those in receipt of the largest apparent incomes, were in want of the common necessities of life. Pichegru, at the head of the army of the North, with a nominal pay of 4,000 francs a month, was in the actual receipt, on the Rhine in 1795, of only two hundred francs, or £8 sterling of gold and silver.‡

"The funds on which the enormous paper circulation was based, embracing all the confiscated property in the kingdom, or land, houses, and moveables, were estimated at fifteen milliards of francs, above £600,000,000 sterling; but in the distracted state of the country few purchasers could be found for such immense national domains; and therefore the security for all practical purposes was merely nominal. The consequence was that the assignat fell to one-twelfth of its real value; in other words, an assignat for 24 francs was worth only two francs; that is, a note for a pound was worth only 1s. 8d.§

"Foreign commerce having begun to revive with the cessation of the Reign of Terror, sales being no longer forced, the *assignat was brought into comparison with the currency of other countries*, and its enormous inferiority precipitated still further its fall.||

"By no possible measure of finance could paper money, worth nothing in foreign states, from a distrust of its security, and *redundant at home from excessive issue*, be maintained at anything like an equality with gold and silver. The mandates were in truth a reduction of assignats to a thirtieth part of their value; but, to be on a par with the precious metals, they should have been issued at one-

* Alison's Hist. of Europe, Vol. III., p. 251.

† Ibid., Vol. III., p. 280.

‡ Ibid., Vol. IV., p. 157.

§ Ibid. Vol. IV. p. 394.

|| Ibid. Vol. V. p. 109.

thousandth part, being the rate of discount to which the original paper had now fallen.*

The excessive fall of the paper at length made all classes perceive that it was in vain to pursue the chimera of upholding its value. On the 16th July, 1796, the measures, amounting to an open confession of a bankruptcy which had long existed, were adopted."

28. We have quoted these passages for the purpose of showing how completely Sir Archibald Alison, when he is speaking of the paper currency of France, acknowledges the great principle, that the value of the paper currency is only to be estimated at the value it will purchase in specie, that the measure of that difference between the real and the nominal value is its *depreciation*, and that a payment in coin at the current value of the paper currency is a NATIONAL BANKRUPTCY. Yet such is the amazing inconsistency of this writer, that when he comes to speak of the paper currency of England which exhibited exactly the same phenomena, only on a smaller scale, he resolutely denies that it was depreciated. When the French assignat had lost one-third of its value compared to specie, in 1791, he acknowledges that it was *depreciated*; when the bank of England note in 1811 had lost one-fourth of its value compared to specie, it was not the note which had fallen, but gold that had risen!! When assignats were made legal tender in France at their nominal value, specie disappeared from circulation. When Bank of England notes were substantially legal tender in England, and had lost a quarter of their nominal value, specie disappeared from circulation. Sir Archibald Alison estimates the depreciation of the assignat by the difference between the current and the nominal value of the assignat; but when the Bullion Committee estimated the depreciation of the Bank note by the difference between its nominal and its current or market value, he reads a homily to them upon their ignorance and folly, talks of the "general delusion

* Alison's Hist. of Europe, Vol. vi. p. 73.

which so long had prevailed upon the subject, when it is recollected not only that the true principles of this apparently difficult, but really simple, branch of national economy which are now generally admitted, were at the time most ably expounded by many men both in and out of Parliament, but that in the examination of some of the leading merchants of London before the Parliamentary Committee on the subject, the truth was told with a force and precision, which it now appears surprising any one could resist." This truth which was told with such irresistible force and precision was, that twenty-seven was equal to twenty-one! He then acknowledges that it was a national bankruptcy of the French government to pay its notes with a less amount of specie than their nominal value; but nothing can exceed the bitterness of his invective against the Currency Act of 1819, which provided that the Bank of England should pay its notes at their full nominal value in specie. Just as if it was less a *bankruptcy* to pay 15s. in the pound than to pay 1s. in the pound. He sees clearly that in *France* the paper currency is to be estimated by the value of gold, but in *England* he maintains that gold is to be estimated by the value of the paper currency!! Just as if the eternal truths of science are different, on different sides of the channel, or that they are reversed according to the language they are expressed in!

29. Nothing could be more amusing, if it did not rather border upon the melancholy, than to observe the amazing inconsistency of Sir Archibald Alison when he speaks of the English and the French inconvertible paper currency. He fully allows that any difference between the nominal and the current value of the assignat was a *depreciation* of the assignat. He never dreams of saying that the paper assignat was the standard, and that the coin had risen in value. But in some remarkably wise lucubrations upon the question of What is a pound? he says,* "In truth, a pound is an abstract measure of

* History of Europe, 1815 to 1852. Vol. II. p. 379.

value just as a foot or a yard of length, and different things have at different periods been taken to denote that measure, according as the conveniency of men suggested. It was originally a pound weight of silver, and that metal was till the present century the standard in England, as it still is in most other countries. When gold was made the standard by the Bank being compelled by the Act of 1819 to pay in that metal, the old word denoting its original signification of the less valuable metal was still retained. During the war when the metallic currency disappeared, the pound was a Bank of England pound note—the standard was the paper—for gold was worth 28s. the pound from the demand for it on the continent.” It is scarcely necessary to point out the ridiculous absurdity of this passage. The pound an *abstract* thing indeed! Our ancestors had very few abstract ideas at all, and certainly an *abstract* idea of a pound was not one of them. They meant nothing abstract, but on the contrary, a very substantial *pound weight of silver bullion*, and nothing else. To say that a paper pound was the standard during the war, is a gross misrepresentation of the fact. Instead of a “promise to pay” on demand, the Bank note during the war was a “promise to pay specie six months after peace.” It is not true that gold during the war was worth 28s. paid in *silver money*, but only in depreciated *bank notes*. But Sir Archibald Alison admits that an excessive issue of paper would have depreciated the bank note, but he of course denies that the issues were excessive. Now, as a depreciation from an excessive issue could only be manifested by a continuous rise of gold above 28s. the pound, we should be obliged to him to explain in his next edition where the turning point would be at which the depreciation would commence. At what figure should we have to reverse our expression,—at what figure are we to say that gold has ceased to rise, and paper begun to fall?

30. Such is a plain statement founded upon incontrovertible facts of the results of the greatest experiment

the world ever saw of issuing a paper currency secured upon commodities or property—the most complete example of LAWISM. When the issues of assignats were at their height, they were certainly not anything equal to the value of the fee-simple of France expressed in silver money. And according to the predictions of Law and Mirabeau, it was a matter of impossibility that they should ever become depreciated, and what was the result? Even though the experiment was not carried out to its full extent, the value of the paper assignat sank to one 30,000th part of its value in silver! There were 2,400 millions of promises of mandate issued, against property valued at 3,785 millions, and yet in July 1796, the note for 100 livres was only 5 centimes!*

Such was the inevitable consequence of basing a paper currency upon property or securities, and such it ever must be, because, if such issues are once begun there is no legitimate conclusion whatever until all the property in the country is coined into notes. Pass the legitimate limits of a circulating medium by one hair's breadth, and there is no logical conclusion but in the French assignats.

31. The next example we shall cite is the Bank of Norway, which was founded on the 14th June, 1816, with its head office at Dronthiem, and branches in the provincial towns.† Its capital was originally raised by a forced loan or tax upon all landed property, and the landholders became shareholders according to the amounts of their respective payments. This Bank was especially for the purpose of forwarding agricultural improvements, and only discounted mercantile bills and personal securities, as a secondary part of its business. Its principal business consisted in advancing its own notes, upon first securities over land, to any amount not exceeding two-thirds of the value of the property according to a general valuation taken in the year 1812. The

* Garnier *Eléments d'Economie Politique*. p. 237.

† Laing's *Norway*. p. 184. Traveller's Library.

borrower paid half yearly to the Bank the interest of the sum that may be at his debit, at the rate of 4 per cent. per annum, and is bound also to pay off 5 per cent. yearly of the principal, which is thus liquidated in twenty years. Mr. Laing bestows great commendation upon this institution, and describes it as well imagined and well managed, and there cannot be a better example to test the truth of Law's principles. We must bear in mind that Law especially declares that on his principle *his paper currency would not fall below the value of silver*. Now, let us mark what took place with regard to the Bank of Norway, which was founded purely on his principle. By the fundamental law of this bank it should after a certain time have begun to pay its notes in specie;* but in 1822 its notes could only be exchanged at Hamburg against silver, at the rate of 187½ dollars in paper for 100 dollars in silver!! That is, in 6 years the notes had fallen to about 45 per cent. discount! Was there ever a more striking or conclusive example of the entire fallacy of Law's predictions than this bank? In 1822 the Storthing passed a law that the bank should only be compelled to give 100 silver dollars for every 190 paper dollars, but that the directors might at their own discretion reduce the rate to 175 without a new law. In 1824 the value at Hamburg rose to 145, in 1827 it rose to 125, and in 1835, when Mr. Laing wrote, it stood at 112, which could only have been done by a contraction of its issues. Now, it is quite evident that if the bank had been called upon to pay its notes at par at any moment it would infallibly have been ruined. This happened in Paris in 1803, when the Land Bank stopped payment, and J. B. Say observes that all banks founded upon this principle have uniformly failed.†

32. The last example we shall cite is the case of

* Laing's Norway. p. 298. Traveller's Library.

* Traité d'Economie Politique. p. 307.

America. That country was unhappily deeply bitten with the currency mania of basing issues of paper on "securities." In most of the States the legislatures passed acts permitting any individual, or any banking associations, to issue notes to any amount upon depositing with a "public comptroller," securities of equivalent value. These "securities" might be public stock, or mortgages upon improved, productive, and unincumbered lands.* Now, as these "securities" remained the property of the vendors, and they might appropriate the revenues from them as long as payment of the notes was not demanded from the comptroller, people saw that they might derive a profit from the security as well as from the currency which represented its value. There was accordingly a prodigious rush to deposit securities—an enormous issue of paper during the years 1834-5-6. The prices of everything rose immensely. The people of the Western States with their "pockets full of paper currency gave very large orders for goods to the merchants of New York, Boston, and Philadelphia, who duly executed them. The bills given for the purchases were payable in these eastern cities; and when the western debtors went to their own bankers for bills of exchange on these places in return for their own local currency, the bankers discovered that their home customers had bought more from the eastern cities than they had sold; that they had already drawn on the east for every dollar which the east was indebted to them, and could draw no more. The western merchants then sent their own currency. notes to the eastern cities in payment, but, unfortunately for them, the merchants there had already paid all they owed to the west, and nobody in New York or Philadelphia wanted western notes for any purpose of use, and nobody was disposed to travel 600 or 700 miles

* A very graphic account of the currency vagaries of the United States is given in two articles of the "*Scotsman*," Nov. 21 and 24, 1855. See also *The Progress of America*, by John Macgregor, Esq., M.P. Vol. II. p. 1068.

to request the cashiers of the Western States to pay their notes, or in those States in which security had been given to require the comptroller to sell the pledged securities and pay them the money produce. Moreover, every one knew that it was physically impossible in either case to obtain the amount in money, for there was no currency in which the pledged property when sold could have been paid, except *Bank* notes resting on securities, or on the mere promise of the banker."* In the meantime, the usual effects followed, specie disappeared from circulation. The extended paper issues led the Americans to order immense quantities of goods from Europe, and prices being very high from the bloated paper currency, they could send no goods in return to pay for them. For some time they sent over great quantities of their stock, but this became superabundant, and at last no one in Europe would buy it. It became necessary then, for them to pay their debts in specie, but specie there was none. In 1837, all the Banks in America, without exception, stopped payment. The general suspension began at New York on the 11th May, and spread in every direction. In May, 1838, the New York banks resumed specie payments, which were followed by all the New England banks in August, 1838; this was followed by the banks in Philadelphia, and on the 1st January, 1839, the banks throughout the Union professed to do so. No sooner, however, were they set up again than they resumed the same wild operations on credit, and on 9th October, 1839, out of 850 banks in the Union, 343 suspended payment entirely, and 62 partially. On this occasion the New England banks were honorably distinguished, they had gathered wisdom, and out of 198 banks in New York, only four stopped; whereas, in the Southern and Western States about two out of three stopped. The United States Bank, with a paid-up capital of £7,000,000, was found to be utterly insolvent; its

* The *Scotsman*, Nov. 21, 1855.

shares, which were at 123 dollars on the 14th August, 1838, were at 3 dollars in January, 1842. This was the fifth grand experiment of Lawism, pure and unadulterated on the most magnificent scale, and such was the result!

33. All ideas, therefore, of basing a paper currency upon property or commodities are essentially erroneous, and can have no other possible termination, if only carried out to their legitimate consequences, than what happened in France in 1796, and America in 1837-9. There is one species of property, however, which from its being more nearly confounded with money in the public ideas than any other, is supposed by many persons, who would repudiate any imputation of being disciples of Law, to be a sound basis for a paper currency. This property is public stock. A very prevalent idea is, that all banks of issue should give security by purchasing the public funds, and then deposit the stock with a government officer. But what is this but the wildest, rankest, and most odious LAWISM? The rule that is good for one is good for all. If the public funds are a proper basis for £1,000 of paper currency, they must of necessity be a good basis to their whole extent. If one bank or banker is allowed to issue paper on the security of stock, every other one must be permitted to do the same, until the whole funded debt of Great Britain is coined into paper notes. If £100 of public debt is coined into £100 of notes, we must by an irresistible conclusion have £800,000,000 of public debt coined into an equal quantity of notes. The principles of basing a paper currency upon land, and upon the public funds, are absolutely identical, and equally vicious. To permit a man to *spend* his money in buying part of the public debt, and to *have* it as well in the form of notes, is as rank an absurdity as to permit him to spend it in land, and also have it as notes. The only advantage one has over the other is, that the funds are more easily convertible into money than land is. The same is true of a nation as

an individual—that a nation can *spend* its money in destroying its enemies and *have* it too as bank notes, or “currency,” is a wild and mischievous delusion.

34. The drift of these remarks is evident. The whole constitution of the Bank of England is fundamentally vicious. It is as complete an example of pure Lawism as the French assignats, or the American banks. It gave its original capital to government, and then was allowed to have it in the form of notes. The first public debt was Bank of England stock, and for several of the early additions to its capital, *i.e.*, the public debt, it was allowed to issue notes to the exact amount of its capital, and this permission still continues. Now, if this system had been carried out to its legitimate conclusion, the national debt and the capital of the Bank of England would have been the same thing, and the paper notes of the bank would have been nearly £800,000,000. When it was founded the nation thought they might spend £1,200,000 in destroying the French, and have them too as bank notes. But if this principle had been carried out much further it would have ended in fatal and universal ruin.

35. The fundamental principle of the Bank of England was, therefore, as erroneous as that of the Mississippi scheme, the Ayr Bank, the French assignats, or American banking; but, as in all these cases, the mischief is not developed until the issues exceed a certain limit, the radical vice of the Bank of England has been prevented from producing its inevitable consequences by rigidly restraining it to that single instance. But then, this vice was kept down by a most unjustifiable monopoly, which was the chief cause of those tremendous banking catastrophes which have desolated England, and which has, until of late years, prevented a sound banking system being founded.

36. We trust that the preceding remarks are absolutely conclusive as to the fundamental fallacy of Lawism of all forms and descriptions, by which we mean, the theory of basing issues of paper on property, or commo-

dities, whether the public funds, or land, or any moveable goods. We must now examine a much more subtle and plausible theory, which was the guiding principle of the Bank of Ireland and the Bank of England during the restriction, and which was adhered to by a large majority of the commercial world; nor are we aware of any refutation of it on philosophical grounds, except the one in the Bullion Report, which we shall quote and comment upon. This theory was first prominently brought forward before the Committee on the Irish Currency, in 1804, and we have quoted it elsewhere.* The Bullion Committee express it in the following words:

“The bank directors, as well as some of the merchants who have been examined, shewed a great anxiety to state to your Committee a doctrine of the truth of which they professed themselves to be most thoroughly convinced—that there can be no possible excess in the issue of Bank of England paper, so long as the advances in which it is issued are made upon the principles which at present guide the conduct of the directors; that is, so long as the discounts of mercantile bills are confined to paper of undoubted solidity, arising out of real commercial transactions, and payable at short and fixed periods.”

37. The germ of this doctrine is to be found in Adam Smith, who says, “When a bank discounts to a merchant, a real bill of exchange, drawn by a real creditor upon a real debtor, and which as soon as it becomes due, is really paid by that debtor, it only advances to him a part of the value, which he would otherwise be obliged to keep by him unemployed, and in ready money for answering occasional demands.”† It was first prominently brought forward as a practical rule by the Irish Bank directors, in 1804. The Committee of that year did not attempt to deal with this theory; but the witnesses examined before the Bullion Committee re-produced it, and alleged that it was the principle by which the Bank of England regulated its issues during the restriction.

* Theory and Practice of Banking. Vol. II., p. 127.

† Wealth of Nations. Vol. II. p. 289. Wakefield's edition.

The Directors of the Bank allowed that, before the restriction, they were compelled to regulate their issues by a drain of gold on them for exportation; when that check was removed, the controlling power was lost; and, indeed, one of the directors stated that, in his opinion, that was one great merit of the restriction; that they were no longer obliged to adhere to their former rules. The Bullion Committee, however, decidedly condemned these opinions. They say, speaking of the consequences of the restriction act:

“ By far the most important of these consequences is, that while the convertibility into specie no longer exists, as a check to an over-issue of paper, the Bank directors have not perceived that the removal of that check rendered it possible that such an excess might be issued by the discount of *perfectly good bills*. So far from perceiving this, your Committee have shewn that they maintain the contrary doctrine with the utmost confidence, however it may be qualified occasionally by some of their expressions. That this doctrine is a very fallacious one, your Committee cannot entertain a doubt. The fallacy upon which it is founded, lies in not distinguishing between an advance of capital to merchants, and an additional supply of currency to the general mass of circulating medium. If the advance of capital only is considered as made to those who are ready to employ it in judicious and productive undertakings, it is evident that there need be no other limit to the total amount of advances, than what the means of the lender and his prudence in the selection of borrowers may impose. But in the present situation of the bank, entrusted, as it is, with the function of supplying the public with that paper currency which forms the basis of our circulation, and at the same time, not subjected to the liability of converting the paper into specie, every advance which it makes of capital to the merchant in the shape of discount, becomes an addition also to the mass of circulating medium. In the first instance, when the advance is made by notes paid in discount of a bill, it is undoubtedly so much capital, so much power of making purchases, placed in the hands of a merchant who receives the notes; and if these hands are safe, the operation is so far, and in this, its first step, useful and productive to the public. But as soon as the portion of circulating medium in which the advance was thus made, performs in the hands of him to whom it was advanced, this, its first operation as capital—as soon as the notes are exchanged by him for some other article which is capital, they fall into the channel of

circulation, as so much circulating medium, and form an addition to the mass of currency. The necessary effect of every such addition to the mass is to diminish the relative value of any given portion of that mass in exchange for commodities. If the addition were made by notes convertible into specie, this diminution of the relative value of any given portion of the whole mass would speedily bring back upon the bank which issued the notes as much as was excessive. But if by law they are not so convertible, of course this excess will not be brought back, but will remain in the channel of circulation, until paid in again to the bank itself, in discharge of the bills which were originally discounted. During the whole time they remain out, they perform all the functions of circulating medium, and before they come to be paid in discharge of those bills, they have already been followed by a new issue of notes, in a similar operation of discounting. Each successive advance repeats the same process. If the whole sum of discounts continues outstanding at a given amount, there will remain permanently out in circulation a corresponding amount of paper; and if the amount of discounts is progressively increasing, the amount of paper which remains out in circulation over and above what is wanted for the occasions of the public, will progressively increase also; and the money prices of commodities will progressively rise. This progress may be as indefinite as the range of speculation and adventure in a great commercial country."

38. Such is the reasoning of the Bullion Report, to shew the fallacy of the rule of the directors. We are not aware of any other attempt to refute it, so elaborate as the one given. The conclusions are perfectly just, but the expressions are in some respects ambiguous, in some, inaccurate; and altogether, the reasoning is inadequate to effect its purpose of demonstrating the fallacy of the doctrine. In the first place, the expression "good bills" is one which we shall shew is full of fallacy. The Report has further been clouded by the false distinction between "capital" and "circulating medium." Again, it says the necessary effect of every addition to the mass of the currency, is to diminish the value of the whole, which assertion is entirely erroneous, because the value of the currency is always proportionate to the work which it has to do; and it is only a change in the proportion between the currency and the work that it has to do, that causes

a change in its value. The committee were further in great error, in supposing that so small an amount as could be added to the circulating medium in so short a time as during the currency of the bills that were discounted, could have any general effect on prices.

39. We shall find that by starting from our fundamental definition of currency, as transferable debt, and that the value of the currency depends upon the quantity of transferable debt which it represents, the fallacy of this theory can be demonstrated with great ease and simplicity, and the mischievous consequences which followed from it explained. When the merchant A, comes to the bank to *discount* the acceptance of B, it is a sale of the debt to the bank. The bank buys a debt payable at a fixed time after date, with its notes, which are so many small debts payable to bearer on demand, while the notes are convertible. The transaction is simply an exchange of debts. At the appointed time, it is B's duty to take a quantity of currency to the bank, and discharge his debt. He does this, either in coin, or in the bank's own notes. If he pays his own debts by the bank's notes, it is simply a re-exchange of debts between him and the bank; he extinguishes his own debt to the bank, and at the same time an equal quantity of the bank's debt is taken out of circulation, and extinguished; consequently, the proportion existing previously between the currency and the quantity of debt it represents, remains unaltered. If the merchant discharges his debt partly in coin, and partly in bank notes, or wholly in coin, the same result follows; the notes which remain out in circulation still represent the same amount of capital. But let us suppose that the acceptor *fails* to meet his engagement, and cannot pay his debt. Then the debt due *to* the bank is lost and extinguished; but the debt *against* the bank remains; and the bank, whilst the notes are payable to bearer on demand, must pay this debt out of its remaining capital. Still, however, though this is loss of capital to the bank, as the notes are taken out of circulation, the value of the

notes remaining in circulation will not be affected. But now let us suppose the notes to be *inconvertible*, then, as before, if the acceptor pays the debt, the notes will be taken out of circulation, and extinguished simultaneously with the debt which they purchased, and the value of those remaining in circulation will not be altered. But suppose that the acceptor fails, and cannot pay his debt, then that debt is extinguished, but the notes which purchased it remain in circulation, and are a mere addition to the circulating medium already existing, without any corresponding addition to the debt or capital which it represents. It would have exactly the same practical effects as if for every good bill of £1,000, the bank were to issue an excess of currency, say £1,500 for example, and when the bill was paid only £1,000 would be taken out of circulation, and the remainder, £500, would remain in circulation. This residuum, as we may call it, would go in diminution of the value of the remainder, exactly in the same way as a constant increase to the gold currency would gradually cause a diminution in its value. Every such operation, therefore, alters the proportion between the currency and the capital, or the debt it represents; and though, no doubt, a few unsuccessful operations of this sort would not have any sensible effect in changing its value, yet a repeated succession of them must necessarily do so ultimately, just as adding a drop to water in a bucket may not perceptibly increase the height of the water, yet a continued series of drops will at length cause the water to overflow the bucket; so a continued series of such operations under an inconvertible paper currency must necessarily result in a serious diminution in the value of the whole.

40. But it may happen, that even though the merchant pays his debt, and no loss of capital ensues to the bank, yet it may be a loss of capital to him. Thus, when he bought the goods on credit, and gave his acceptance for them, which was purchased by the bank, he meant to employ those goods as *capital*, that is, he bought them

merely for the purpose of selling them again, with a profit. If he succeeds in this object, and sells them to advantage, he pays his acceptance out of the proceeds realised by the goods, and his capital is increased more or less, according to the greater or less advantage he sells them at. But if he has made a miscalculation, and sells the goods at a loss, he must still make good his debt to the bank out of his remaining capital; and such a transaction is a loss of capital to him. But every loss of capital to an individual is a loss of capital to the whole community.* And the great general result to the community is absolutely the same, whether the loss of capital falls upon the individual or upon the bank. The capital of the nation is diminished, but the currency remains the same. Consequently, every unsuccessful operation in trade alters the proportion between the quantity of the currency and the quantity of the debt, or the capital it represents; and, therefore, every unsuccessful operation necessarily tends to diminish the value of the whole currency, unless some means can be devised by which a quantity of currency can be removed from circulation, corresponding to the loss of capital. Now, the diminution in the value of the currency inevitably shews itself in process of time, by a general rise in prices. It may do so gradually and imperceptibly at first—in the hourly variations of prices, it may not, perhaps, be perceived at first; just as when the waves are breaking upon the shore, it is impossible to tell whether the great tide is advancing or receding; but if it continues for any length of time, all traders begin to feel it instinctively. It is impossible, perhaps, to point out the precise influence in any particular transaction; but yet, it makes itself felt in commercial operations, by a general rise in prices. The fact is, that when the operation was done, and the production

* J. B. Say has also remarked this: "Un mauvais speculateur est aussi fatal à la prospérité général qu'un dissipateur." *Traité d'Economie Politique*. p. 445. Edit. Guillaumin.

exposed for sale, it was expected and calculated that a certain portion of currency would be appropriated to its purchase. But if people do not want the article, they will not appropriate that portion of currency to its purchase; the producer loses his capital, and the currency remains in circulation. And the increased quantity of it gradually enters into the prices of other commodities, aggravating them, and swelling them up. Now, when this is the case, when the currency is made of a material which has an universally acknowledged value, nature herself provides the remedy. When commodities rise in price in this country beyond their prices in foreign countries, besides the cost of transporting them here, they will be imported, and the extra quantity thrown upon the market diminishes their price, both by altering the ratio of supply and demand, as well as by removing the quantity of currency necessary to pay for them, from circulation, until the general equilibrium is again restored between prices, currency, and capital. But if the currency be made of a material which has no value whatever, like paper, this great restoring process of nature cannot take place. The quantity of currency remains the same, while the capital it represents is diminished. The consequence is, a general diminution in value of the whole currency—all the portion of the currency which has intrinsic value is driven out of circulation; then follows a great rise in the market price of bullion, and as a necessary consequence, a fall in the foreign exchanges.

41. The foregoing considerations enable us to affix a definite and specific meaning to a phrase which is now in constant use, but which we have never yet seen any attempt to explain. All discussions upon currency are full of misty and vague expressions about "excessive issues," "over-issues," but we have never seen any attempt to define what an "over-issue" is. Now, "over-issues," in general, must consist of specific instances of over-issue in particular cases. Where is the use or the sense of casting vague and indefinite accusations against the bank of

making "excessive issues," unless the person who makes the charge is prepared to point out specifically which issues are excessive, and which are not? Now, the meaning which we affix to an "excessive issue," or an "over issue," is an advance upon an unsuccessful operation, or the "purchase of a bad debt." Every quantity of currency advanced to promote an unsuccessful operation, or which purchases a bad debt, alters the proportion between the currency and the debt, or the capital it represents. Each specific instance, then, of such an operation is an "over-issue," and the expression "over-issue," or "excessive-issue," has no other meaning.

42. The foregoing considerations also show the complete fallacy of the theory we have been discussing of issuing notes upon "good bills." In a banker's sense a "good bill" means simply a bill which is duly paid by the proper party at maturity. It is not the smallest consequence to him whether the transaction out of which the bill originated is a profit or a loss to the person who incurred the obligation, as long as he is paid. But if the expression "good bill" be taken in a more extended and philosophical sense to denote a bill upon which it is safe to issue currency, it is a very different matter indeed, for then a "good bill" can only mean one generated by a successful operation.

43. It is not a little remarkable that Adam Smith is the parent of both the theories of paper currency, which have imposed so extensively on the banking and mercantile world, and that within a very few pages of each other. The one theory, that which the bank directors and merchants adopted in 1810; the other, which is the huge currency fallacy of the present day. The two theories are utterly irreconcilable and inconsistent with each other; the one necessarily leads to the most excessive over-issues and depreciation of the paper currency, the other, if carried out in all its integrity, would be utterly destructive of the business of banking. These two theories thus springing up close to each other, and then

pursuing diametrically opposite directions, are something like the Rhine and the Rhone, which rise within a few miles of each other and then separate, one flowing due south and the other due north.

44. What then is the only true foundation of a paper currency? Every consideration of sound reasoning and science proves that the only true foundation of a paper currency is that substance which is the legal or the universally accepted representative of DEBT, *i. e.*, of services due, or CAPITAL, whatever that substance be. Now, among all civilized nations gold or silver bullion is the acknowledged representative of debt, or capital. Consequently, gold or silver bullion is the only true basis of a paper currency. Among all civilized nations the *weight of bullion is the acknowledged measure of value*, and consequently, bullion is the only true basis of the representative of value. Many unthinking persons declaim against the absurdity of founding a paper currency upon the *commodity* of gold bullion rather than any other commodity, such as wheat, or silk, or sugar. But it is not as a *commodity* that bullion is the basis of a paper currency, but as the substance which is the accepted representative of *debt*, or capital. It would be perfectly possible to make a yard of broadcloth, or a Dutch cheese, the representative of debt, and the measure of value; then broadcloth or Dutch cheeses would be the only true basis of a paper currency, and to issue paper upon the basis of bullion would, in such a case, be as improper as to issue paper on the basis of broadcloth or Dutch cheeses under existing circumstances. But all nations are agreed that bullion is better fitted by nature for such a purpose than broadcloth or Dutch cheeses; and, consequently, as it seems to be the substance pointed out by nature herself for representing debt, it is the substance which forms the only true basis of a paper currency.

45. Bullion, then, as the symbol of capital, is not only the sole proper basis of a paper currency, but is the

only true regulator of its amount. As all paper currency is a "promise to pay" gold or silver bullion at some definite time, it is quite evident that the "promises to pay" floating in a nation must bear some proportion in quantity to the actual quantity of the bullion. It is quite impossible to fix any definite proportion, because that depends upon a multitude of peculiar circumstances. Experience is the only guide on the subject.

46. Capital and credit, or money and promises to pay money, then, form the only true circulating medium or currency, and they are its limits. If the limits of capital and credit are once transgressed, we plunge at once into the dread abyss of Lawism, and there is no logical goal till we arrive at the assignats of 1796, or the issues in America in 1837; and even these did not reach the full limits allowed by the theory. It is impossible to exceed the boundaries of capital and credit by a single iota, without involving this absurdity—*that we can buy a thing and keep the price of it as well.*

47. Capital and credit, then, must always increase and decrease together. If a man's real capital is reduced from £1,000 to £100, it is quite clear that he cannot safely keep in circulation as many "promises to pay" as when he had £1,000, and if his real capital is leaving him, he must reduce his liabilities in a similar proportion. If he chooses to spend £500 in buying commodities, such as corn, it is quite clear he cannot spend the money, buy the commodity, and have the price as well. Now, what is true of a single individual is equally true of a bank, or of a nation. When an ordinary bank feels a drain upon its bullion, it must reduce its liabilities, its "promises to pay," or else the ruin of that bank is certain. Now, some people think that though this must be true of a private bank, yet it is the reverse of true applied to the Bank of England, and that as its bullion *decreases*, it ought to *increase* its issues. Sir Archibald Alison frequently reminds us of the truism that the same great law regulates the fall of a pebble and the motion of

the planets. So we may say, that the same great law regulates the relations between the credit and the capital of the humblest individual, the smallest bank, the Bank of England, and the British nation. Some people think that as capital decreases credit should increase. What makes the credit of Great Britain so great? Because her capital is so great. Why is the credit of Russia so low? Because her capital is so small.

48. The operation of reducing "issues" or "advances," is always one which will excite much complaint, and requires to be done with much delicacy; and, indeed, the grand problem in regulating the paper currency, is to discover the true mode of acting upon it, so as on the one hand to maintain always its uniformity in value with the coin it represents, and on the other not to contract it too suddenly and violently, and without giving the public sufficient warning to enable them to reduce their liabilities in proportion.

49. From the amazing confusion of language and thought which pervades almost all treatises on monetary science, the plain and obvious method of controlling the paper currency has almost entirely eluded observation. No person who apprehended the true nature of banking, and expressed it in simple language, could fail to see the natural controller. The main business of commercial banking is discounting mercantile bills—that is, buying debts. Discounting a bill for a merchant is not *lending* him money but *buying* a debt due to him; and the price of such debts must follow exactly the same laws as the price of corn, or any other article. If money is very scarce, and wheat very abundant, the price of wheat must fall; if money is very abundant, the price of wheat will rise. The price of debts obeys the same rules. If capital becomes very scarce, the price of debts must fall, *i. e.*, the discount must rise. If capital becomes abundant, the price of debts will rise, *i. e.*, the discount will fall. The price of debts, then, must follow the same great laws of nature that the price of wheat does. Now, does

not every man of common sense know that it is the most foolish and insane thing to try to control the price of wheat? As we have shown in another place, it is not the fluctuation of the price of wheat that is the evil, but it is only the *sign* of the evil. The real evil is the change in the proportion of the demand and supply, and the fluctuation of the price is the grand natural corrector of the evil. Does not every one know that a high price of corn is the way to *attract* corn where it is deficient, and a low price the way to *repel* it from where it is already too abundant? Does not every one of common sense know that it is the most fatal folly to force down the price of wheat when there is a real scarcity, and to sell it below the price it would naturally attain? Can any course be more suicidal?

50. Now, apply all the arguments which suggest themselves so irresistibly in the case of wheat to the case of credit, or the purchase of debts, and the same results follow. The same great law of nature operates to preserve the due proportion between capital and credit, and any interference with this great law must necessarily be attended with the same evil consequences, as an interference with the natural price of wheat. And yet, almost all legislation up to a very recent period, and almost all writers on political economy, and too many of the commercial world, are in a perverse combination to thwart this great law of nature, and attempt to keep the rate of discount, or the price of debts, fixed at a uniform scale!

51. While, therefore, the greater part of commercial complaints are levelled against variations in the rate of discount as the great evil, the truth is, it is only the *sign* of the evil. The real evil is the altered proportion between capital and credit, and a variation in the rate of discount is the grand natural corrector of the evil. To attempt to keep the rate of discount uniform, is to thwart and contravene the laws of nature just the same as an attempt to fix the price of wheat. Like all true laws of nature, the simplicity, beauty, and perfection of its action

is marvellous, and it produces a multitude of results which are not perhaps very obvious at first. If capital is leaving the country and becoming scarce compared to credit, every principle of nature shews that the value of money must rise, *i. e.*, the rate of discount must rise; and this has a tendency to prevent the outflow of bullion and to attract it from abroad; on the other hand, if capital be flowing into the country and likely to become too abundant compared to credit, a fall in its value, or a fall in the rate of discount, *repels* it from the country. If a nation be visited with a great failure of the crops, it can only buy such food from foreign countries with its commodities or its money, it cannot send its credit in payment abroad. Now, if commodities are too dear, it must pay with money, and credit in this country is the great producing power, and credit *for a time* is a great sustainer of prices by enabling people to withhold their commodities from the market. Now, raising the rate of discount curtails credit, forces sales, and thereby lowers the prices of commodities, and makes it less profitable to export specie, and more profitable to export goods. Moreover, this rise in the value of money here, *i. e.*, the low price of debts and commodities, tempts buyers from neighbouring countries to bring their money here. It thus causes an inflow of bullion, and restores our currency to an uniformity of value with that of neighbouring countries. Again, if this nation has to spend a great part of its money in buying foreign corn, it is quite clear that it has not got so much to spend in purchasing goods; an over-production of goods, therefore, can only end in a disastrous fall in prices. And here, too, the beautiful action of this great law of nature is manifest. So enormous a proportion of the commodities of this country are produced by the credit system, that a rise in the rate of discount just hits profits between wind and water, as we may say. Consequently, a rise in the rate of discount retards and curtails production in proportion to the diminished consuming powers of the nation, and so prevents such a

ruinous fall in price as would necessarily follow an undiminished production accompanied by a diminished power of consumption.

52. In fact, when a commercial crisis occurs in a country, it invariably means that more persons are wishing to sell than there are persons to buy, or at least at remunerative prices. A commercial crisis invariably arises from a lack of purchasers, which is, in fact, over-production. True prudence, therefore, shews that in all commercial crises, *production should be curbed*. It is much better not to produce at all, than to produce and be obliged to sell at a loss. To produce and be obliged to sell below the cost of production is loss of capital. It is better, therefore, not to employ the capital at all, than to lose it. Raising the rate of discount, therefore, acts as a timely warning to producers to hold hard. It is necessary to dispose of the stock already produced, before producing more, and if the stream of sale is stopped while production continues, it can only end in a more aggravated fall at last.

53. Now, what is the necessary consequence of an attempt to thwart this great law of nature? In time of scarcity of food, and a necessary export of money to buy it, if the rate of discount be kept unnaturally low, nothing but money will go, commodities are too dear, they will not go. Again, money being kept at an unnaturally low rate here, no one will bring it here from neighbouring countries, consequently, great quantities of money will go out and none will come in, till at last the circulating medium will be nothing but "promises to pay," and no money to pay them with. Then, at last, violent convulsions, total destruction of credit, every one wishing to sell, and no one wishing or able to buy.

54. On the other hand, if when capital is flowing in with too great abundance, it be not repelled by a due diminution in the value of money, *i. e.*, a fall in the rate of discount, it will continue to do so until it is so superabundant that a violent fall takes place. Persons who

are accustomed to depend on the incomes they derive from the interest of money. suddenly find that their means are seriously diminished;* then wild speculations find favor in the public mind, promising higher profits, and then the community goes through the cycle of bubble speculation, extravagant credit, ending in a commercial catastrophe. We may feel quite certain that if during the various crises this country has passed through, there had been more attention paid to observe the natural rate of discount, instead of thwarting the course of nature, though the variations would have been more frequent, they would have been less violent and extreme. If capital is coming in with too great speed, it is good to lower the rate of discount quickly to prevent it getting lower; if capital is going out too rapidly it is good to raise the rate quickly to prevent its being higher.

55. Such, however, is the perversity of men that many think that a uniform and invariable rate of discount is the great thing to be preserved, no matter what nature may say to the contrary, and their ingenuity is racked to devise a plan for always keeping it so, just as if the governor of the steam engine ought always to revolve with uniform velocity. Now, the inevitable consequence of taking these means to thwart nature will be, that when capital is scarce, it will be repelled by a lower rate than the natural one; when it is already too abundant, it will be still further attracted by a rate higher than the natural one.

56. The extreme anxiety of persons to attain an impossible object, always to have the power of selling debts due to them at a uniform rate, has led to a very prevalent theory, which seems very innocent and simple. It being desirable always to maintain the currency at a uniform amount, they propose that as gold goes out paper should be issued to supply its place. This theory

* In the year 1824 there was such a plethora of capital in the country that the Scotch banks gave no interest on deposits; after 1824 came 1825.

is adopted by Sir Archibald Alison, who says, after condemning the theory that gold and paper must vary together,*

"The true system would be just the reverse. Proceeding on the principle that the great object is to equalize the currency, and with it prices and speculation, it would *enlarge* the paper currency when the precious metals are withdrawn, and credit is threatened with a stoppage, and proportionally contract it when the precious metal returns, and the currency is becoming adequate without any considerable addition to the paper.

57. There would be certainly something specious in the idea of issuing Bank notes to supply the place of the gold that went out, if unfortunately it had not been tried over and over again, and been attended uniformly with a catastrophe. When gold was leaving the country in vast quantities in 1796, the Bank of England still maintained its issues, against its own will, it is true, but yet the *fact* illustrates the *principle*, and the consequence was the suspension of cash payments in 1797. When the Bank had got right again in 1817, a drain for foreign loans began, and the Bank extended its issues in 1818, and the consequence was the second suspension of cash payments in 1819. In 1824, when bullion was departing from the country like a flood, the Bank extended its issues; then when it saw itself right in the vortex of bankruptcy, it suddenly altered its policy, and the result of all this was the catastrophe of 1825. In 1838-9, a similar drain occurred, the Bank with marvellous perversity maintained its rate of discount considerably below the market rate, and the result was the monetary crisis of 1839. In 1847, there was the same error and the same result. Surely these instances are enough to destroy this fatal delusion.

58. In fact, Sir Archibald and the great body of public writers who share these sentiments, wholly mistake the object to be sought for in so delicate and artificial a machine as a paper currency. The object to be

* History of Europe, 1815-1852. Vol. II. p. 391.

aimed at is not to preserve a uniform rate of discount in this country, but to maintain a uniformity in the value of the British currency with that of other countries. If money is made artificially cheap in this country, that is, cheaper than it is in neighbouring countries, persons in this country will *export* it to where it is of greater value; they will buy foreign securities, they will import foreign commodities. On the other hand, foreign nations will flood this country with their securities—just as the Americans did in 1839, when the Bank kept down the rate of discount below its proper level—because they can sell them at a better price here than in their own country. If a man wishes to sell a horse, and my neighbour will only give £90 for it and I will give £96, he of course will sell the horse to me, and take away my cash. So when the Americans wished to sell their debts, and found that in their own country they could only get £90 per cent. for them, whereas they could get £97 per cent. for them in England, as a natural consequence they sent them to England for sale, and took away the cash. The only way for England to have stopped this would have been to give no more for these securities than the Americans would themselves; in other words, to maintain a uniformity in value between the currencies of the two countries.

59. When the foreign exchanges are unfavorable to this country, the simple meaning of that is, that it is profitable to export gold. Now, where is the gold got from for exportation? From the Bank of England. And how is it got from there? By getting hold of the bank's "promises to pay" gold on demand. Now, when the Bank of England knows that a multitude of persons are trying to get hold of its promises to pay, for the purpose of demanding gold for them, to carry out of the country, would it not be the height of folly in the bank to be multiplying its "promises to pay" in all directions, and selling them cheap? This would be exactly as wise as if the captain of a ship, directly he saw a storm coming

on, were to set all his studding-sails and royals. When the captain sees the tempest approaching, he must get down his top-gallant masts and reef his topsails; so, when a commercial tempest is threatened, it behoves those who pilot the vessels of credit to *contract* their "promises to pay."

60. The plan proposed by Sir Archibald and a multitude of unthinking writers, is, that when gold is leaving the country, commissioners should be appointed to issue an equal amount of inconvertible paper, which is to be withdrawn when gold comes back again. But what is to be done with the convertible paper already in existence? Is it to be declared inconvertible? For, as long as the rate of discount is depressed, there will be a constant demand for gold in exchange of notes, and a corresponding amount of *inconvertible* paper must be issued. Let this wonderful theory be put in practice, and the drain will not cease until every sovereign has left the country; and moreover, they never will come back again. For, as the avowed intention is to keep down the rate of discount, and to keep up prices, there is nothing to bring the bullion back again. Nothing can bring it back again here, except we can sell our commodities or debts cheaper than other nations. But it is the avowed intention of these issues to prevent that; consequently, no bullion ever will come back.

61. But, moreover, this wonderful panacea of all monetary ills—issuing an inconvertible paper currency, to supply the place of the gold that goes out—is just our old friend John Law's scheme over again, of issuing paper currency based upon commodities. Those who advocate this think that the nation can send its money abroad to buy food, and have it as well in the form of paper money. Just as if a man might go into a shop, spend his money there in buying goods, and then have it again in the form of a "promise to pay." When will this stupendous delusion be eradicated from the public mind? If I have a certain quantity of money in

my till, I may safely give a "promise to pay;" or, if I know for certain that money is coming in to me on a certain day, I may give my "promise to pay" at a certain date; but when I have actually spent my money, and it is gone away from me for ever, to think that I can then grant a "promise to pay" worth anything, is an idea which savours little of sanity. In 1696-7, during the re-coining of the silver, the Bank of England might have issued £1 notes with the greatest advantage and propriety for a temporary purpose, because it knew that it would shortly have the money to pay them with; but when the money is gone from the bank to buy corn abroad, it would be the most dangerous folly possible, to issue notes to supply the place of gold.

62. But there are several other considerations which point out that the rate of discount is the true method of acting upon the paper currency. As soon as the exchange becomes so unfavorable as to make it profitable to export gold, an immense number of bills are fabricated for the purpose of being sold for the sake of the premium; and these will continue to be fabricated as long as the rate of discount is kept below that of neighbouring countries; now, raising the rate of discount strangles all such operations in the birth. If only the *numerical* amount of notes be looked to, and the rate of discount be kept down, these speculators may get their bills passed, while legitimate trade bills may be refused. A moderate rise in the rate of discount will never inflict any real injury on trade at all equal to the refusal to discount trade bills altogether; and that is the result which has always ensued from a perseverance in keeping down the value of money below its natural level.

63. Moreover, when the nation is actually obliged to spend its money in buying foreign corn, or on any other object, such as war, it is quite impossible that it can have so much money to spend upon other things; its consuming powers, therefore, are diminished; it must economise in other things. Now, if the rate of discount

is kept below its natural level, it stimulates and encourages production so much beyond the powers of consumption, that it must necessarily terminate in an aggravated fall in prices. A timely raising of the rate of discount is, therefore, a warning to producers to contract their operations gradually. But keeping it unnaturally low, lulls them into false security; they maintain their engagements on credit on an undiminished scale, till at last, the Bank, for its own safety, is obliged to pull up on a sudden—to bring up all standing. Then follows a total refusal to discount, commercial panic, and ruin.

64. It is, then, an incontrovertible fundamental truth in monetary science, that capital and credit form the circulating medium, and that they must increase and decrease together. An increase of currency, without an increase of capital, has no effect but to diminish the value of the currency. The same thing happens, if, when capital is destroyed, currency is not destroyed with it. If a metallic currency increases faster than capital, nature provides a remedy; it is immediately exported. But with an inconvertible paper currency, this cannot happen, and when capital is destroyed, currency remains in circulation; when this goes on for any length of time, or to any extent, the inevitable result is a depreciation of the paper currency, which is shewn by the rise of the market above the mint price of gold. This was eminently exemplified in England in the years subsequent to 1810. The extravagant speculations were followed by an enormous destruction of capital; but the currency which was issued to represent it remained in circulation, and soon manifested itself in a rapid fall of the value of paper. It was impossible that paper ever should right itself, unless this superfluous currency was destroyed. It is recorded that an Irishman, once having taken a dislike to a banker, in order to spite him, collected a number of his notes and burned them. It would have been an excellent thing for the country bankers of England in

1814-15, if some one had done the same kind office for them. The quantity of paper currency was so excessive, compared to capital, that nothing could restore it to its par value, but the destruction of a large portion of it; and this was brought about by the destruction of the issuers of it; and when this was done, the value of the remainder rose to par.

65. We have gone over most of the theories of currency which have attained the greatest practical importance. That there are others, is true; but they have generally been confined to a small knot of fanatics. There is said to be a Birmingham theory of currency, a Currency Reform Association; but as they have never promulgated their views in an authoritative exposition, we believe that the general public has no definite idea of what they are—no more than they have themselves.

66. Every one knows that it is recorded of the ancient Spartans, that they used to make their helots drunk, for the purpose of exhibiting to their rising youth the disgusting practical effects of intoxication. Even so have other nations exhibited before the eyes of Great Britain the hideous convulsions which are the infallible consequence of adopting the insane theories of currency we have been discussing in this chapter. And are we not to profit by these terrible lessons? Is the bitter experience of other nations to be thrown away upon us? We hope not. These things were written for our learning. And yet, so deep-seated in human nature is this fatal delusion—so utterly blind and insensible are a vast number of public writers and speakers to the bitter lessons of experience, that there is a very general demand upon the Government to embark in a career which, by an inevitable law of nature—which the most terrific examples of experience shew can have but one goal—the dread abyss of UNIVERSAL INSOLVENCY.

“Evertere domos totas optantibus ipsis
Di faciles!”

67. In the year 1705, the Parliament of Scotland

turned a deaf ear to the delusive fallacies of John Law, and sent him about his business, to play his financial pranks in other countries, and the result was, the Mississippi scheme! In the year 1855, the representatives of commerce in the same city which rejected John Law with ignominy 150 years before—namely, the Edinburgh Chamber of Commerce—set him up as their patron and their model, and memorialized the Government, and “do most emphatically object to the plan of restricting the security (upon which the paper currency is based) to the possession of gold alone;” and we regret that they do not stand alone in such sentiments. In fact, we swarm with Laws, Chamberlaynes, and Briscoes at the present day. Foolish men weary the compositors, and vex the public ear with their crazy projects for issuing paper currency based upon land or upon commodities, each one thinking that it is some grand new discovery. Whereas it is an old antiquated folly which has been repeatedly tried and uniformly failed, and the idea that there is any thing novel in these visionary chimeras is only founded upon their entire ignorance of the subject.

68. Now, let it be clearly understood what these persons require:—it is nothing less than a depreciation of the currency. Every issue of paper currency not based upon bullion, is nothing more than a depreciation of the existing currency. In its practical effects, it is exactly equivalent to making a ninepenny or sixpenny shilling, only it is rather disguised, so as to escape the notice of persons who do not understand the subject. All nations have had recourse to this description of fraud when they were pinched in their national expenditure, or by political circumstances. It is the resource and the sign of troubled times, and of thievish kings. It was so at Athens,—at Rome,—at Constantinople; it was so in the perturbed era of the middle ages at Florence, as we learn from the pathetic apostrophe of the poet:*

* Dante. *Purgatorio*. Cant. vi.

"Fiorenza mia * * *

 * * *

Quante volte nel tempo che rimembre
 Legge, MONETA, ed uficio, e costume
 Hai tu mutato."

It was so in England—in Scotland—in France; and under the flimsy disguise of letting the mint price of gold conform to the market price, it is the prevailing cry of a great number of persons at the present day—persons, too, whose education should make them ashamed of being deceived by so transparent a sophism. With such a distempered state of the public mind, there can be nothing more desirable than that a discussion should be brought on in Parliament, on the specific question of basing a paper currency on anything else whatever than bullion, in order that such folly and madness may receive its quietus once and for ever.

CHAPTER VI.

SKETCH OF THE HISTORY OF THE CURRENCY OF ENGLAND.

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1. We propose in this chapter to give a very short sketch of the most prominent historical facts connected with the currency of England, from William I. Such a knowledge is indispensably necessary to understand the Political Economy of any country, and also to test the truth of certain doctrines which were propounded by government in the famous currency debates in 1811, and are still believed in by a not inconsiderable number of persons. So far as regards Political Economy, the currency is the binding force of society; and a disorder in the currency loosens the whole framework of the community. Lord Macaulay says with not greater point than truth, "it may well be doubted whether all the misery which had been inflicted on the English nation in a quarter of a century. by bad kings, bad ministers, bad parliaments, and bad judges, was equal to the misery caused in a single year by bad crowns and bad shillings."*

Hist. of England. Vol. iv. p. 625.

2. At the time of William the Conqueror, the measure of value was the pound of silver, Cologne weight of 5,400 grains, which had been introduced by the Saxons. It was also called Tower weight, from the Mint being placed in the Tower. The quality of the bullion was 11 oz. 2 dwts. fine, and 18 dwts. alloy. This was called the "Old right standard of England," and is that in use at the present day, as it has been proved by experience to confer the greatest amount of durability on the metal. This, however, was only money of account, there being no actual coin of that weight. The only actual coin was the famous silver penny. The Saxons also introduced another imaginary coin for the purposes of account, which they called *scil* or *scilling*, supposed to be derived from the Anglo Saxon *scylan*, to divide. This sum sometimes denoted four, and sometimes five pennies. William I. established the Saxon Shilling at four pennies, and the Norman at twelve; thus corresponding to the *solidus*, into which the French pound was divided, which has been corrupted into the modern *sou*. The Norman shilling was still only money of account, and never was reduced into an actual coin before Henry VII.

3. About this time the term *sterling* came to be applied to English money, by which it was distinguished on the continent, as it still is. There are a great many different etymologies given for the word,* but the most probable is, that it was derived from the festival of Easter, when official examiners visited the Mint, and examined the coinage. The word Easter is derived from the Saxon goddess Eastr, whose festival fell in April, and as that nearly coincided with the great Christian festival, April was usually called Easter monat (Easter month). The word sterling was applied not only to the quality of the coin, but was specifically appropriated as a name of the English penny.

4. Previous to the union of the different petty king-

* Ruding's Annals of the Coinage. Vol I. p. 7.

doms of the Saxons, each of the kings, archbishops, and several of the bishops, exercised the right of having a distinct coinage. This privilege was abolished by Athelstan, with the advice and concurrence of a grand council, who decreed that there should be but one money throughout the kingdom. But while all subjects were forbidden to mint independently, many of them received grants from the crown to mint on its behalf; and in early times there were instances of royal, episcopal, and abbatical mints existing at the same time in the same place, and this privilege was not wholly abolished till the middle of the 16th century.*

5. In the reign of Henry I. spurious and false coinage had proceeded to a great length, giving rise to great inconvenience. In 1108 a new coinage was found necessary, and the severest penalties of mutilation were denounced against coiners. All these penalties were ineffectual, and in 1123 a council at Rome denounced the penalty of excommunication against all circulators of false money. In 1125 the money had become so corrupt that it would not pass in any market, and 94 persons underwent mutilation, and among them several of the moneyers themselves suffered.†

6. Stephen being immersed in a civil war, had recourse to the expedient of debasing the coinage. Fortresses and feudal castles every where sprang up during these troubles, and every one had its mint, which issued base money with only one-tenth of silver. There were no less than 1,115 of these castles destroyed by Henry II. in 1154, and their mints suppressed. Two years afterwards he issued a new coinage, and twenty years after that another new coinage was issued ‡

7. In 1205, John appointed an assize to put an end to clipping and counterfeiting. All money which wanted 2s. 6d. in the pound was declared illegal, and ordered

* Report of the Royal Mint Commission. p. 5. (1849.)

† Ruding's Annals of the Coinage. Vol. I., p. 163.

‡ Do. p. 167.

to be destroyed. Trafficking in light coin, was forbidden, and legal weights were delivered at the Mint office to all applicants to test the weight of the coin. All coins made after Christmas in the 6th year of his reign, and clipped, were to be bored through, and the holder treated as a thief, and the severest penalties were enacted against clippers. Thus, we see in this reign the utmost attention was paid to the weight of the coin. *

8. In 1227, Henry III. held a council in London, when it was ordered that the English groat should be of a certain weight, with the effigy of the king on one side, and on the other a cross as large as the groat, to prevent clipping. In 1229, the Pope's tithes were levied with great severity, and many persons were obliged to borrow money of the Cahorsini, who then for the first time came over with the Pope's nuncio. It was the remission of this tribute which, we have every reason to believe, gave rise to the invention of bills of exchange, which is often, but without any authority, attributed to the Jews. In 1247, a proclamation was issued, that any clipped penny should be bored through, and that all money not of lawful weight should not be current. Never had the coin been in so degraded state as in the troubles of Henry III.; it was clipped down to half its weight. Prices rose enormously, and immense quantities of foreign base coin were in circulation. †

9. In 1279, Edward I. issued a complete new coinage, and proclamation was made against the currency of the clipped coin. In the 8th year of his reign he ordered all coins to be of the fineness of 11 oz.; two easterlings, one farthing fine; and 17½d., one farthing alloy. The pound of money ought to weigh 20 shillings and 3 pence. In the 28th year of his reign, the penny was reduced from 24 grains to 23.7073 grains Tower. In 1303, it was enacted, that the penny was to weigh 32 grains of wheat taken from the middle of the ear. An anonymous author

* Ruding's Annals of the Coinage. Vol. I., p. 178,

† Do. p. 183.

says, "that he stamped leather money, which he used in the building of Caernarvon, Beaumaris, and Conway castles." *

10. In 1310, in the troubled reign of Edward II., a petition of the House of Commons stated that the money was clipped down to one-half. In 1311, another proclamation against the importation of false money issued, but with little success; and in 1319, the Barons of the Exchequer were directed to order the Sheriffs of England to make proclamation that no one should import foreign clipped or counterfeit money, under very severe penalties, and all such as had any should bore it through, and bring it to the Mint to be re-coined. These proclamations, though frequently renewed, were wholly ineffectual.†

11. This inveterate grievance of the depreciation of the currency was one of the first abuses Edward III. was called upon to remedy. In 1331, several proclamations of the same tenor as the former ones, were issued; one provision was, that the black money which had been commonly current, should cease to be so one month after that date. But good coin continued to be very scarce, and it is asserted that the scarcity of coin caused a great fall in prices in 1336.‡ It is useless to multiply instances of these proclamations. It is sufficient to state that the state of the currency was a chronic disease, and that the financiers of that age had not discovered the fundamental principle of the currency, that good and bad coin cannot circulate together.

12. The constant disappearance, however, of the good coin, led to a solemn deliberation in Parliament upon the currency question, who called in the advice of certain merchants, goldsmiths, and moneyers, who were charged to give their advice how good money might be prevented from going out, and counterfeit money from being brought in. A statute, containing several provisions regarding

* Ruding's Annals of the Coinage. Vol. i., p. 192.

† Do. p. 207.

‡ Do. p. 211.

the silver money, was passed as the result of these deliberations. But as these persons had no real scientific knowledge on the subject, we cannot be surprised that they were of no avail. One very important measure, however, was resolved on, namely, to introduce a gold coinage to make up for the scarcity of silver. Henry III. had previously made this attempt, but it failed. The permanent restoration of gold as a substance of currency, took place in 1344, when the legislature agreed that three sorts of gold money should be issued; they were called florins, maille florins, and farthing florins, and of the value of 6s., 3s., and 1s. 6d. respectively. They were called florins from the famous coinage of Florence, but instead of the Florentine lily, they bore as a device the lions of England, termed leopards in heraldry. This money was rated too high, and merchants refused to receive it, and it was consequently recalled. A new coinage was struck, called nobles, maille nobles, and ferling nobles. The noble was 6s. 8d. They were considered to be the most pure, valuable, and beautifully executed coins of their day, indeed they were so extraordinarily beautiful, that even men of sense so late as the days of Elizabeth, were not ashamed to repeat that they were produced by the famous charlatan and alchemist, Raymond Lully, in the Tower.* But this beautiful coinage obeyed the great hitherto undiscovered law. It was exported in large quantities, and false and counterfeit coin of all sorts was imported, and the old plan of issuing proclamations against such practices was repeated, with their usual inefficacy.†

13. The history of the currency for many years is nothing but the same uniform story of chronic disarrangement, and it is useless to enumerate the dates of these repeated proclamations, as our purpose is sufficiently answered, which was to shew that the weight of bullion

* Camden's Remains. Art. Money, p. 176. Edit. 1623.

† Ruding's Annals of the Coinage. Vol. 1., p. 225.

in the coin was always esteemed of the utmost consequence. The next event which we need notice, was the reduction of the old Saxon money of account, the shilling, to an actual coin. This was done in 1503, the 18th Henry VII. This contained 144 grains of pure silver, and as a modern shilling contains 80.7 grains it was intrinsically worth 1-9.408d. of our money. This year, in which a great recoinage was effected, was further remarkable for the first coinage of the 20s. piece, called the sovereign. Twenty-two and half of these pieces were coined out of the pound tower, and they therefore contained 240 grains of pure gold. We should express this in modern terms by saying that the Mint price of gold was £22 10s. a pound. A modern sovereign contains 113.12 grains of gold, consequently the sovereign of Henry VII. was intrinsically worth £2 2s. 5d. of our money.

14. Edward IV. reduced the penny to 12 grains of silver. Henry VIII. still further reduced it to 10 grains by debasing the "old right standard of England" to two ounces of alloy to ten of silver. The state of the silver coinage being extremely bad, the value of the gold coin of course appeared to rise, and it was accordingly exported. In order to put a stop to this, the sovereign was ordered to pass current for 22 shillings, and afterwards for 22s. 6d. In the 18th year of his reign the pound tower was abolished as the measure of weight, and the pound troy, which is three quarters of an ounce less, was substituted for it. Up to this time all the different gold coins were made of a different alloy, which caused great intricacy in settling accounts, but now the standard that is now in use was established, viz. 22 carats fine and 2 alloy. In the year 1545, the coins were reduced to the greatest state of debasement that ever disgraced the English mint, except a small quantity of silver in Edward VI.'s reign. The gold was reduced to 20 carats fine and 4 carats alloy, the silver to four ounces fine and eight ounces alloy.* This caused much public

* Ruding's Annals of the Coinage. Vol. 1. p. 310.

discontent, and Camden notices it among the calamities of the latter part of his reign.

15. The state of the coinage was so intolerable that it was at last determined by the council of Edward VI. in 1551, to reform it. A proclamation was issued stating the great debasement of the coinage, and the advantage that would arise from the amendment of it, and restoration to its former standard. In order to promote this, the shillings and groats then current were reduced to ninepence and three pence. The natural consequence immediately followed, prices everywhere rose. But in order to obtain bullion to reform the coinage the somewhat singular plan was hit upon to debase it still further, and a quantity was ordered to be issued of 3 ounces fine and 9 ounces alloy, to discharge debts.* The people were in the utmost state of confusion at this meddling with the value of the money. To put a stop to this a very severe proclamation was issued forbidding any one to talk of the debasement of the coin, on pain of imprisonment or mutilation. Nevertheless, within a month the coin was still further cried down. The writers of the day notice the terrible sufferings of the poor, owing to these repeated tamperings with the coin. And Cowper, Bishop of Winchester, says, "the richer sort partly by friendship, understanding the thing before hand, did put that kind of money away, partly knowing the baseness of the coin, kept in store none but good gold and also silver, that would not bring any loss." Thus, we see the *fact* noticed that in a depreciated state of the currency, all the good coin vanishes from circulation, and is hoarded or exported, although the time was not yet come when men could see that the two circumstances were connected. The derangement of the usual relations between the coin and bullion was so great, that bullion rose to 12s. the ounce, and the old angels which were coined to represent 6s. 8d., rose to 21s. The evident meaning of which was,

* Ruding's Annals of the Coinage. Vol. I. p. 309.

that there was only an ounce of silver in 12s. of coin, and that the money was so debased, that 21s. of the bad money was only equal to 6s. 8d. of the good. These are exactly the identical phenomena which afterwards excited so much controversy in the reign of William III. and in the great currency controversies in 1811 and subsequent years, when the Bank note exhibited exactly the same phenomena of depreciation as the debased currency in money. The relative values of the precious metals were so little understood, that while silver was rated at 12s. the ounce, gold was only valued at 60s. or five times the value of pure silver, and at one time it was further reduced to 48s.

16. But the council of Edward VI. was so thoroughly impressed with the frightful disorders caused by this monetary anarchy, that they were taking serious measures for an entire restoration of the coinage when the sickly boy died, before the measure was completed. In 1551 the standard of the silver had been brought back to 11 oz. 1 dwt. fine and 19 dwts. of alloy, being only 1 dwt. worse than the old standard. Silver was rated at 3s. 5d. the ounce, and gold at 60s., being little more than 11 to 1. During the brief reign of Mary the usual proclamations were issued, and the usual complaints were made that people bought up the good coins at higher prices than they were rated at, and melted them for exportation.* The gradual progress of the restoration of the coinage seems to have been continued, but we know that it must necessarily have failed while the bad money remained in circulation.

17. No sooner had Queen Elizabeth ascended the throne, than she turned her attention to the state of the currency, being moved thereto by the illustrious Gresham, who has the great merit of being as far as we can discover, the first who discerned the great fundamental law of the

* Ruding's Annals of the Coinage. Vol. I. p. 330.

currency, that good and bad money cannot circulate together. The fact had been repeatedly observed before, as we have seen, but no one, that we are aware, had discovered the necessary relation between the facts, before Sir Thomas Gresham. As this is of fundamental importance in Political Economy, it may perhaps interest our readers to quote the first passage that we are aware of in which it is noticed. It was during the great misery caused by the Peloponnesian war at Athens, that a spurious and debased gold coin was first issued, 407 B.C. The old Attic currency, which was always distinguished for its remarkable purity, immediately disappeared from circulation. And the fact is thus noticed by Aristophanes; * "The state has very often appeared to us to be placed in the same position towards the good and noble citizens, as it is with regard to the old currency and the new gold. For we make no use at all of those which are not adulterated, but the most beautiful of all money, as it would seem, which are alone well coined and ring properly, both among Greeks and foreigners, but of this base copper struck only yesterday, and recently, of a most villainous stamp. And such of the citizens as we know to be well born and prudent, and honorable gentlemen, and educated in the palæstra, and chorus, and liberal knowledge, we insult. But the impudent and foreigners, and the base born, and the rascals, and the sons of rascals, and those most recently come, we employ." This fact thus first noticed by Aristophanes was, as we have already seen, repeatedly noticed by contemporary writers in England. But Sir Thomas Gresham was we believe the first to affirm that one was the cause of the other. He was presented to the Queen only three days after her accession, by Cecil, and she immediately employed him to negotiate a loan which was necessary in the exhausted state of the Treasury left by Mary. Before leaving for Flanders, he

* Ranae. 665. Edit. Holden. Cambridge, 1848. Quoted in Lord Macaulay's Hist. of England. Vol. iv. Chap. 21.

wrote a letter of advice to the queen explaining how, among other things, all the fine money had disappeared from circulation. The cause of this he attributed to *the debasing of the coinage by Henry VIII.** Now, as he was the first to perceive that a bad and debased currency is the *cause* of the disappearance of the good money, we are only doing what is just, in calling this great fundamental law of the currency by his name. We may call it Gresham's law of the currency. He earnestly recommended the queen to bring back the currency to its former purity, and in accordance with this advice, the queen soon carried through the work in earnest. On the 27th September, 1560, a proclamation was issued stating the enormous evils of the debased currency, and the coins were all reduced to their true value, and the holders of them were desired to bring them to the mint, where they should receive good coins in exchange. Soon afterwards the old national standard of silver was restored, and has continued to the present day. The weight of the silver penny, which was 8 grains at the beginning of her reign, was reduced to $7\frac{1}{4}$ at the end of it.

18. Though the queen was as we have seen careful to restore the currency of England to its proper purity, she seems to have received a most extraordinary twist in her judgment, when she began to think of Ireland. In addition to the internal ills of that unhappy country, the English sovereigns had always been in the habit of adding that of a purposely debased currency. The details are much too long to be inserted here, but they will all be found in that great mine of information regarding the currency, Ruding's *Annals of the Coinage*. Nor had Queen Elizabeth, though sound in her ideas respecting the currency of England, been one whit behind her predecessors in her absurdity regarding the currency of Ireland. To shew the utter confusion of ideas that prevailed, we would recommend to those who take an interest in this

* Life of Gresham. Knight's Weekly Volume p. 101.

subject, to read "the case of mixed money in Ireland," in the State trials,* where it was solemnly determined that bad money was equal to good in Ireland, though it was acknowledged that bad money was *not* equal to good in England. This case is instructive to read, as it turns on the too common blunder even at the present day of confounding the name or *denomination* of a coin with its *value*, the name it is called by with its purchasing power, or what it will exchange for. The decision in this case is of equal wisdom with one which should decide that in England four was equal to four, but that in Ireland, four was equal to three!

19. We need not remark anything that occurred till the reign of Charles II. when the old national coin of England, the silver penny, ceased to be struck. In 1664 a splendid gold coinage of £5, £2, and 20s. pieces was issued. The latter were called guineas, because they were made from the gold brought from Guinea, by the African company. The pound of crown gold was coined into 44½ guineas, and continued to be so as long as guineas were coined. However, no legal rate was imposed upon these new coins, and they were allowed to find their own level in commerce, the consequence of which was that they soon were above their nominal value.

20. The old evils soon reappeared; clipping and counterfeiting flourished. The coinage became continually more debased throughout the reign of James II., and became rapidly worse after the revolution of 1688. The usual old useless remedies were tried. Acts of parliament were heaped upon one another, and multitudes of unfortunate wretches expiated on the gallows their crimes of clipping and forging; without having the least effect in arresting the evil. The state of the silver coinage was so bad, that in 1694, guineas had risen to 30s., and the exchange was 25 per cent. against England. It was alleged that the shillings contained scarcely 3d. of silver.

* Vol. II. p. 114.

21. This great evil at length attained such a height that it was taken up by parliament, and on the 8th January, 1695, a committee was appointed to consider the subject. It is said* that the clipping and adulteration of the coin "had increased so much of late by the combination of all people concerned in the receipt of money, and so industriously promoted by the enemies of the Government, that all pieces were so far diminished and debased, that £5 in silver specie was scarce worth 40s. according to the standard, besides an infinite deal of iron, brass, or copper washed over or plated." The frightful disorder of the silver currency at this time may be judged of by the following facts. One writer says,† "upon trial I have found that 5s. of milled money hath weighed 8s. of the present current money, and 3s. of the 8s. was not clipped, only worn. Again, I have found 10s. in milled money to weigh 21s. of the clipt money. Again, 20s. of milled money to weigh 43s. of our new current money." He also went to six of the principal goldsmiths in London and got them to weigh out £100 each, and the total £600 weighed only what £310 ought to have done. The money in the country was no better. Having got two bags of £100 each weighed at Bristol, Cambridge, Exeter, and Oxford, the £800 weighed only as much as £431 should have done. In the months of May, June, and July, 1695, 572 bags of silver coin, each of £100, were brought into the Exchequer, whose aggregate weight according to the standard ought to have been 18,451 lbs. 6oz. 16dwts. 8grns.; their actual weight was 9,480 lbs. 11oz. 5dwts. making a deficiency of 8,970 lbs. 7oz. 11dwts. 8grns., shewing a depreciation of the current coins in the ratio of 10 to 22. The exchange as we have observed fell to 25 per cent. against England, and would have been much more, only that the real commer-

* Parliamentary Hist. Vol. v. p. 955.

† An Essay for Regulating of the Coin. by A.V. Sept. 2, 1695. In the Library of Eton College.

cial exchange was in her favor. At the same time the market price of silver rose to 7s. 2d. the ounce.

22. Contemporary writers were perfectly well aware that the bad state of the coinage was the true cause of the rise in the price of guineas, as it is usually called, though it is much more correct to call it a fall in the value of shillings. One of them writing in 1695, says:*

“And so, by degrees, as the silver coin was diminished and debased in itself, so it fell in the estimation of the people, and in proportion gold advanced, and also bullion, (that is not in itself, but in proportion to the bad money,) not that bullion became worth 6s. 5d. an ounce, or gold 30s. a guinea in good money, that is in weighty standard money, but in clipped and counterfeit money, whereof 6s. 5d. was not of the true or esteemed value of 5s. 2d. And as we ourselves grew sensible of the want of value in money that passed, so did foreigners likewise, and the foreign exchanges soon altered accordingly, so that it cannot properly be said that bullion is advanced much, or that gold is advanced much, or commodities are advanced much, but the money that is exchanged for them, is of much less value than it was, and the new coining of our money will not, as I apprehend, alter the value of bullion, gold, &c., but it will bring silver in coin to its due value.”

After enforcing and illustrating these views at considerable length, he observes that Mr. Lowndes hoped that the exchange with Holland, which was then 25 per cent. against England, might be prevented falling lower; and says, page 16:—

“If guineas continue current at 30s. a piece, the exchange will continue about the rate it does, except the common and ordinary variation, which many sudden drafts and remittances occasion; and if guineas fall, the exchange will rise in proportion, and if the silver coin is redressed, guineas will fall; and there are no other designs whatsoever can effect any considerable alteration, for English standard silver and standard gold will always be of the same value in Holland, as the same standard silver and gold in England within 2, 3, 4, to 6 per cent., or thereabouts, and that difference happens according to present occasions, and the charge of sending it from one

* Some Remarks on a Report containing an Essay for the Amendment of the Silver Coins, by Mr. W. Lowndes. London. 1695. p. 6.

place to another, and the exchange to Holland and other places, always governs accordingly."

Again, at page 19, he says: "It is not the exportation of the silver which occasioned the fall in the exchange between Holland and here, but the reason of that is the badness of our silver coin." And again: "The balance of trade is not the cause of the great fall of the exchange for Holland, but the debasing of our coin." And he repeatedly declares that the only way to set matters right was to reform the coinage. In the above extracts we see that the great principle that the real exchange could never vary beyond the expense of transmitting bullion, was perfectly well known to the writer. John Law also entirely attributes the disorder of the exchanges, and the price of bullion, to the badness of the coin.*

23. Parliament met in November, 1695, and the king in his speech called the attention of the House to the state of the currency, and requested them to provide a remedy. Then followed the first great parliamentary debate on the currency question in modern times. Mr. Montague, the Chancellor of the Exchequer, said† that the mischief would be fatal if a present remedy was not found out, and applied. That by reason of the ill state of the coin the change abroad was infinitely to the nation's prejudice. That the supplies that were raised to maintain the army would never attain their end, being so much diminished and devoured by the unequal change and exorbitant premiums before they reached the camp. That this was the unhappy cause that the guineas advanced to 30s., and foreign gold in proportion. Notwithstanding the opposition of the country party, who maintained that that was not the season to undertake so perilous a work, the House decided to call in and recoin the silver money. This point having been carried, the next point was to decide whether the several denominations of the new

* *Memoire sur les Banques.* p. 537. Edit. Guillaumin.

† *Parl. Hist.* Vol. v. p. 968.

money should have the same weight and fineness as the old; or whether the established standard should be raised. This question produced many debates; those who were for raising the standard argued that the price of an ounce of silver bullion was advanced to 6s. 3d., and therefore the standard ought to be raised to an equality. That the raising of the standard would prevent this exportation of the coin, and the melting of it down, which of late years had been much practised; and that it would encourage people to bring in their plate and bullion into the mint.

24. The government replied,* "That the worth of money was relative, and to be rated by the measure of such goods, labor, advice, skill, or other assistances, as could be purchased from another by our parting with it. That the value of money among foreigners, who lived under different municipal laws, was intrinsic, and consisted in its weight and fineness. That common consent had given it this value for the common conveniency of supplying one another's wants. That the weight and fineness was the only worth, that other nations regarded in our coin, as we in theirs; all money being between subjects of different governments of no greater value, excepting the workmanship, than so many pieces of uncoined bullion. That, therefore, should our standard be altered, we should still be on the same foot with our neighbours, for if we were to pay them for their goods, or exchange our money with theirs, whatever denomination we gave our money, they would in their charge ever reduce it to an equality with theirs, and proportion the quantity and goodness of their commodities to the weight and fineness of the money they were to receive for them, so that in respect of our foreign commerce there was no reason to alter our standard. That at home if the standard were raised, great confusions would attend it, the landlord would be defrauded of a

* Parl. Hist. Vol. v. p. 970.

great part of his rents, and the creditor of his debts. That the seaman and the soldier would be wronged in their pay, and many the like injuries and inconvenience would happen. That it was no answer to say that they might buy as much goods and conveniences of life with this coin, raised above its standard, as they could before, because by degrees the seller would infallibly raise the price of his goods in proportion to the new raised standard, and that of this there was an instance before them, all commodities being raised in their prices, while guineas were paid for 30s. That whereas it was alleged that the price of bullion was risen to 6s. 3d. and therefore the standard of the silver coin ought to be raised likewise, it was replied, that it was a thing impossible that the price of silver could rise or fall in respect of itself. That it was an unchangeable truth, than which no mathematical demonstration could be clearer, that an ounce of silver would ever be worth another ounce of the same fineness, and no more, allowing some inconsiderable disparity upon the account of the coin, if one ounce be in coin, and the other in bullion. That it was true, indeed, that the people commonly gave 6s. 3d. for an ounce of bullion; but that they gave only clipped pieces, that had no more than the sound of shillings and pence, but were by no means the thing themselves, that is, they were not the standard shillings of due weight and fineness, and were no more so in the just sense of the word, than an ell is an ell, when the third part of it is cut off. That the case was so plain, that when they demanded of those who affirmed an ounce of bullion to be worth 6s. 3d., whether they meant six milled shillings and three pence, they know not what to reply. For this alteration of the value of bullion was merely in relation to diminished money, and to make it yet more evident, they urged that it was matter of fact that with 5s. 2d., of new milled money, they could buy as much bullion as they pleased, while those who bought it with clipped pieces paid 6s. 3d.

25. The Chancellor then moved a resolution, that in coining the new money, the House would not depart from the ancient standard, either in weight, fineness, or denomination; and it was voted that the expense of the recoinage should be borne by the public, and a fund of £1,200,000 was voted for the purpose by laying a tax upon windows.

26. The Commons then addressed the Crown to issue a proclamation, to name a day when the currency of the clipped money should absolutely cease. This was accordingly done on the 19th December, but unfortunately the time was so short, that it threw all trade into the utmost confusion. People refused to receive the old money lest it should be left on their hands. On the 21st January, 1696, a motion was brought forward, that the House should take in consideration the price of guineas, but it was negatived then. But on the 10th of February, the question was again brought forward and agreed to; and on the 13th the House resolved itself into a Committee of the whole House. On the 15th, it was resolved by a majority of 164 to 129 that guineas should be lowered to 28s. On the 28th of February, they were again lowered, by a majority of 194 to 140, to 26s. and on the 26th of March, they were lowered to 22s.* It was further ordered that the clipt money should be received in payment of taxes till the 4th May, in advances to government till the 1st July, and after the 1st February, 1697, should cease to be current. At this time, although gold and silver were legal tender, yet the silver coin was considered as the standard currency, and gold only subsidiary. Debts were considered to be contracted in silver, and when the great disarrangement of the relative value of gold and silver took place it was considered as a great public grievance. All the heavier pieces were culled

* An Account of the Proceedings in the House of Commons, in the relation to the recoinage of the clipped Money, and falling the price of Guineas. In the Library of Eton College.

out, and sent to Holland, where guineas and bullion might be bought for 22s. which passed for 30s. in England. The consequence was a steady drain of silver from England and a constant influx of gold. Exactly similar phenomena have recently manifested themselves in France, from analogous causes.

27. But a new element had now been introduced into the English currency, which was, henceforth, to exercise a potent influence in controversy, namely, BANK NOTES. In 1694, the Bank of England had been founded. Its purpose was totally different from that of the Bank of Venice. We have seen that the purpose of the latter bank was merely to remedy the badness of the coin, and provide a uniform standard of payment to merchants. Consequently, though it gave its notes in exchange for clipped and light coin, it only gave them for the actual amount of bullion in them. Consequently, if payment of its notes was demanded, it was not liable to give more bullion than it had received. But the Bank of England had not had this providence, it gave its notes for the clipped and light money for their full nominal value. It had numerous enemies and rivals to contend with, who were only too eager to ruin its credit.* While the clipped coin was called in, scarcely any of the new was issued. Evelyn says, "that there was not enough current money to make the smallest purchases, even of daily necessities, but all was on trust." In this extremity the bank notes were still payable to bearer on demand. On the 4th May, 1696, its enemies made a combined run upon it, which compelled it to adopt a partial suspension of payments; they gave notice that they could only pay 10 per cent. on their notes, once a fortnight, and as the demand continued, they were obliged to reduce that to 3 per cent. every three months.

* Lord Macaulay's Hist. of England, Vol. iv., Chap. xxi. Theory and Practice of Banking, Vol. II., Chap. viii.

28. In consequence of this suspension of payments, the notes soon fell to a heavy discount. On the 3rd of August, Evelyn tells us that they were at 14 or 15 per cent. discount, and they continued their descent till they reached a discount of 20 per cent., in October. But by this time the newly coined money had come forth in sufficient abundance, and the exchanges were immediately brought back to par. In a pamphlet, dated 22nd October, 1696, it says :

“ When our coin was corrupt and base, all exchange rose upon us, but now it is returned to its ancient standard, exchange returns to its old course; not that the standard of our money is always the exact rule of our exchange, the balance of our trade often causes it to alter, either to our advantage or to our loss, besides the charge of management; but this is little in comparison with the other. A familiar instance we have in the case of Ireland, where, whilst our coin was base, seventy pounds was worth one hundred pounds here, which was in some measure proportionable with the value of pieces of eight, which they took in Ireland by weight, to our clipt money, and also to our guineas at 30s. a piece; and how far this carried the trade of England into that kingdom, the traders of the West Indies have been too sensible, but since the error of our coin hath been corrected, that very exchange is so much varied, that one hundred pounds here is worth one hundred and fifteen pounds there.

“ And since I have mentioned guineas, I cannot let them pass without some observations. How eager was the contest for keeping them up to that exorbitant value! and how unwillingly did the money changers, and those whom they had deceived, yield to the alteration. Whereas, it was well known that the occasion why guineas were so high was the badness of our coin.”

This is a conspicuous and decisive example of the truth of the principles in the chapter on exchanges, that a restoration of the coinage is alone sufficient to bring the exchanges nearly to par. The exchanges were brought to par in October, 1696, when bank notes were at a discount of 20 per cent., and exchequer tallies of 40, 50, and 60 per cent. Bank notes were still at a discount in June, 1697.

29. The effect of these measures was that guineas were at length brought to be current for the same sum as they had been before the great disarrangement of the coinage. They were restored to their former value of 21s. 6d. and remained so until the year 1717, when another alteration in the market value of gold and silver began to be sensibly felt. The want of adjustment between the rating of the gold and silver coins, compared with the market value of the two metals, immediately made itself felt in the way we have previously noticed, and as it always will do under similar circumstances, the disappearance from circulation of the metal which is underrated. At this time it was silver that was underrated, and it was exported in such quantities as to cause a severe scarcity of silver coin. On the 19th Dec., 1717, the subject was brought before the House of Commons by Mr. Aislable, the Chancellor of the Exchequer. He said* the great scarcity of the silverspecie was in all probability occasioned by the exportation of the same, and the importation of gold, and proposed that a speedy remedy should be put to the growing evil by lowering the value of the gold specie. Mr. Caswall seconded the motion of Mr. Aislable, and after discussing the various values which gold and silver coins had borne with respect to each other, argued that it was the over valuation of the gold which had occasioned the exportation of great quantities of silver specie. This had given rise to a great foreign trade, which consisted in importing gold into this country in exchange for silver, and the gold being coined produced a profit of nearly 15 pence on each guinea. Nothing could be clearer or sounder than this argument. If persons can buy a greater quantity of gold abroad with silver than they can here, they of course will export their silver, and *vice versâ*, if persons abroad can buy more silver here than they can in their own country with the same quantity of gold, they will certainly send their gold here to buy up

* Parl. Hist. Vol. vii. p. 523.

all the silver they can, and if the state of the law be persisted in, which degraded silver below its real value, it can end in only one way, viz., by the total disappearance of silver from circulation.

30. The increasing magnitude of the evil had already occupied the attention of the government, and they had, on the 12th of August previously, desired Sir Isaac Newton, the Master of the Mint, to investigate the subject generally and to report to them upon it. He reported* that by the market values of the two metals, the guinea was worth but so much silver as would make 20s. 8d. instead of 21s. 6d. He showed this necessarily caused an exportation of silver. He calculated the different comparative values of gold and silver in different countries of Europe, according to the Mint regulations of their coinage, and shewed that, owing to these, silver had a natural tendency to leave England and Spain, and flow into Sweden. He stated that in China and Japan, gold was only nine or ten times as valuable as silver, and in the East Indies about twelve times; and that this great cheapness of gold there, caused a drain of silver from all Europe to the East. "And it appears by experience as well as by reason, that silver flows from those places where its value is lowest in proportion to gold, as from Spain to all Europe, and from all Europe to the East Indies, China, and Japan, and that gold is most plentiful in those places in which its value is highest in proportion to silver, as in Spain and England." He pointed out that it was the inequality in the valuation of these two metals, that caused so much transmission of one or the other from place to place, "and if gold were lowered only, so as to have the same proportion to the silver money in England, which it hath to silver in the rest of Europe, there would be no temptation to export silver rather than gold to any other part of Europe. And to compass this last, there seems nothing more requisite than to take off about 10d.

* Parl. Hist. Vol. vii. p. 556.

or 12d. from the guinea, so that gold may bear the same proportion to the silver money in England, which it ought to do by the course of trade and exchange in Europe; but if only 6d. were taken off at present, it would diminish the temptation to export or melt down the silver coin; and by the effects would show hereafter better than can appear at present, what further reduction would be most convenient for the public." "If things be let alone till silver money be a little scarcer, the gold will fall of itself, for people are already backward to give silver for gold, and will in a little time refuse to make payments in silver without a premium, as they do in Spain; and this premium will be an abatement in the value of gold, and so the question is, whether gold shall be lowered by the Government or let alone till it falls of itself by the want of silver money."

31. In conformity with this report, the House of Commons addressed the Crown to issue a proclamation to make guineas current at 21s. each, and so proportionably for any greater or less pieces of coined gold, which accordingly was done by proclamation, dated 22nd of December, 1717. Both Houses of Parliament passed resolutions that no alteration should be made in the standard of the gold and silver coin of the realm in fineness, weight, or denomination.

32. Considering that the true principle of a metallic currency was not yet adopted, viz., to have but one standard of value, the next best thing was done to make the relative values of the coins as nearly as possible conformable to their market values, and this was the last change which the valuation of gold underwent, and in the language of the Mint, the Mint price of gold was then fixed at £3 17s. 10½d. per ounce. But from Sir Isaac Newton's own Report it appears that the full difference between the Mint and market values was not abolished, and the difference that was preserved has caused a very remarkable change in the British currency, for whereas silver had been the standard coinage of the country, and gold had

only been introduced as subsidiary to it, the great scarcity of silver during the last century, owing to the underrating of the silver, and the neglected state of the coinage, caused the merchants to prefer to discharge their bills in gold, instead of silver, and this custom of paying in gold, and considering all contracts to be made in reference to gold, became so firmly established, that gold at length superseded silver as the standard currency of England, and silver was degraded to the same rank as copper, and is only used now for the purpose of coining tokens called shillings, half crowns, &c., to serve as a small change for sums below the gold unit.

33. Notwithstanding the repeated experience the government had received of the evils and inconvenience of allowing the currency to fall into a degraded state, they gathered little wisdom from it, and the coinage continued to deteriorate during the following reigns, till at the accession of George III., in 1760, it was in as bad a state as ever. The market price of bullion rose greatly above the Mint price, and the foreign exchanges fell, but nothing was done to remedy it. The state of the law left open one wide door of temptation to tamper with the coinage, though it was issued at full weight from the Mint, there was no care taken to preserve it at full weight,—there was no limit declared, which if it fell below, it should cease to be legal tender. The consequence was that a thin wafer of metal was as much legal tender as a full weighted coin. In former times when the clipping and wearing of the coin had proceeded to extreme lengths certain temporary proclamations were issued, declaring coins below a certain weight not to be legal tender; but it is a remarkable circumstance that, ever since the invention of coining, which was for the very purpose of certifying that there was a certain amount of metal in the coin, no state seems to have provided that, if from any circumstances the actual weight of the metal did not correspond to its certified amount, it should cease to be legal tender. From this negligence an extravagant idea got abroad, that

it was the mere appearance of a certain piece of metal, or mere phantom, which was called a pound, that was efficacious in commerce.

34. Owing to the inattention paid to it, the coinage in 1771 had fallen into a most disgraceful and alarming state. The gold coins had never been so deficient ; three fourths of the silver was base.* In this and the following year the Mint prosecutions for offences against the coin increased largely. In the next year an Act was passed (Statute 1773, c. 71) which, stating in the preamble that the preventing the currency of clipped and unlawfully diminished and counterfeit money was a more effectual means to preserve the coin of the kingdom entire and pure than the most rigorous laws for the punishment of such as diminish or counterfeit the same ; and reciting that by the known laws of the kingdom no person ought to pay, or tender in payment, any counterfeit or unlawfully diminished money ; and that all persons might not only refuse the same, but might and were required by law to destroy and deface the same, it was enacted that any person to whom such unlawfully diminished or counterfeit money should be tendered to deface or destroy it, and forbade it to be received in payment of Taxes.

35. A Committee of the whole House having taken the bad state of the gold coinage into consideration, reported, on the 10th of May, 1774,† that a quantity of the gold coin, which had been received at the Bank at the Mint price to an amount of the nominal value of nearly three millions and a half, was deficient in weight upon an average 9 per cent. ; that part of the gold coin in circulation which was coined before 1763, was deficient 5 per cent., and that what had been coined between 1763 and 1772. was deficient about $2\frac{1}{2}$ per cent. ; that, while pieces of gold coin differing so greatly in weight were allowed to be current under the same denomination, and at the

* Ruding's Annals of the Coinage, Vol. II., p. 83.

† Parliamentary History, Vol. XVII., p. 1327.

same rate and value, the new and perfect pieces would continue to be exported and melted down. To remedy this they proposed that all guineas weighing less than 5 dwts. 8 grs., and smaller coins in proportion, should be called in and recoinced. They also resolved, "That the only effectual method of preserving the gold coin from being unlawfully diminished, and of preventing the mischiefs to which the public is thereby exposed, is, that the said coin should be current by *weight* as well as by *tale*;" and, "That the most convenient method of making the gold coin so current is, that every person who shall receive in payment any piece, or number of pieces, of such coin deficient in weight, shall be entitled to receive a compensation for the said deficiency from the person tendering the said coin," at a certain rate. They also proposed, "That for a limited time the silver coin of the kingdom be not allowed to be legal tender on the payment of any sum exceeding £50, but according to its value by weight after the rate of 5s. 2d. per ounce."

36. In pursuance of these resolutions an Act (Statute 1774. c. 42) was passed, by which it was enacted that no tender in the payment of money made in the silver coin of the realm, for any sum exceeding £25 at any one time, should be legal tender for more than according to its value by weight at the rate of 5s. 2d. per ounce.

37. In this year, 1774, a great recoinage was carried out, and the market price of gold bullion well illustrates the principles so frequently enunciated in the course of this work.

BEFORE THE RECOINAGE.

				Market price of Gold.		
July,	1718	.	-	3	19	10
January,	1721	-	-	3	19	10
"	1730	-	-	3	18	11
"	1754	-	-	3	18	5
"	1761	-	-	3	18	10
"	1772	-	-	4	1	0

AFTER THE RECOINAGE.

January, 1782	-	-	3	17	6
„ 1790	-	-	3	17	6

And it continued at this rate till September, 1797.

38. In 1796, immense quantities of gold specie were sent abroad to subsidize foreign powers, at the same time vast quantities of bank notes were locked up in advances to government. Various political causes also combined to create a great pressure on the Bank of England,* and on Sunday, the 26th February, 1797, at a meeting of the Cabinet, an order was sent to the Directors to suspend payments in specie until the sense of parliament could be taken on the subject.

39. The stoppage of cash payments had no effect on the value of the bank note for three years. But in 1800, the harvest was lamentably deficient. Wheat rose in March, 1801, to 156s. a quarter, and a great series of commercial disasters took place at Hamburg. Discount there rose to 15 per cent. As a natural consequence, bullion immediately flowed from London to Hamburg, and in January, 1801, the exchange stood at 29·8, being upwards of 14 per cent. against England.

40. We have already seen that in the great monetary crisis of 1696-7, it was universally acknowledged by parliament and the most eminent merchants, that it was the bad state of the coinage which produced the great rise in the market price of bullion, and the heavy fall in the foreign exchanges; and we have seen that the restoration of the coinage immediately rectified the exchange. At that time bank notes were not a legal tender, and the language invariably applied to them, when their current value differed from their nominal value, was that they were at a *discount*. When the men of that day saw that

* For a full account of the circumstances preceding the suspension of cash payments, see *Theory and Practice of Banking*. Chap. viii.

the bank notes were a promise to pay so many "pounds" on demand, and when they saw that the persons who issued them were unable to pay that number of pounds, and that no one would give that number of pounds for them, they never used any other expression regarding these facts than that the notes were at a discount. There is no trace of any one having thought of saying that it was the notes that denoted the pound sterling, and that bullion had risen. When the reform of the coinage took place, and the exchanges were simultaneously rectified, it was said that the reform of the coinage *caused* the restoration of the exchange, and numerous merchants had written pamphlets to combat a delusion which was rather prevalent among some persons, that bullion as a commodity could have a different value to bullion as coin, except on account of the depreciation of the coinage.

41. Adam Smith had laid it down as a principle, that any permanent difference between the market and the mint-price of bullion must be necessarily caused by the condition of the coinage itself; and Hume had observed that the exchange never could vary but very little beyond the cost of the transmission of specie;* which principle, indeed, as we have already seen, was perfectly well known to the merchants, in 1696. All these fundamental truths, which are as pure matters of demonstration as any proposition in Euclid, had been discovered and established long before the period we are now speaking of.

42. Such were the truths established when a metallic currency was the only one thought of, in estimating value. But at this time a new principle was introduced—there was what was substantially an inconvertible paper currency. At this period most men's ideas were transferred from the metallic currency to the paper currency. Ever since the issue of the £1 notes, people thought of them when they spoke of prices as being so many pounds.

* Hume's Essay on Money.

When the suspension of cash payments first took place, there was a general expectation that the bank notes would be depreciated, but the general resolution of bankers and merchants, to support the credit of the bank, the determination of the government to receive bank notes in payment of taxes at their par value, and the great caution exercised by the directors during the first few years after the restriction, had removed all these apprehensions, and for some years the bank notes circulated at par.

43. At this time, however, phenomena occurred which directed the attention of many persons to the state of the paper currency. The market price of standard gold up to September, 1799, had continued at £3 17s. 6d. per ounce, and the price of foreign gold in coin had been somewhat higher, on account of its greater use as coin than as bullion. But in June, 1800, the price of foreign gold experienced a sudden and extraordinary rise; it rose to £4 5s. per ounce; silver rose to 5s. 7d. per ounce; and the foreign exchanges fell below par. In January, 1801, gold and silver had each risen 1s. per ounce, and the exchange at Hamburg was at 29s. 8d., being a depression of 14 per cent. below par. But the expense of transmitting specie to Hamburg was estimated not to exceed 7 per cent., and consequently there remained a difference of 7 per cent. to be accounted for.

44. It was at this time that the great and palpable truth was discovered, that if a deterioration of the coinage produced a rise of the market price of bullion above the mint price, and a fall in the foreign exchanges under a metallic currency, then that the opposite proposition was also necessarily true. That under a paper currency which was only the representative of a metallic currency, if the market price of bullion (*i.e.* the paper price) exceeded the mint price, and the foreign exchanges fell beyond the cost of the transmission of specie, that excess could only arise from the depreciation of the representative of the metallic currency, and therefore that when these circumstances occurred THEY WERE

LIBLY INDICATED THAT THE PAPER CURRENCY WAS DEPRECIATED.

45. We are not certain to whom the merit of the discovery of this great and important truth is due. If he had not the actual merit of discovering it, Mr. Walter Boyd was certainly one of the first to proclaim it, and call public attention to it. It was enforced with much greater ability and clearness by Lord King,* and with not so much distinctness by Mr. Henry Thornton, in his *Inquiry into the Effects of Paper Credit*. To these three writers, however, as far as we have been able to ascertain, the merit is due of establishing this principle, which is as important in the subject of currency, as the Newtonian law of gravity is in astronomy.

46. The preliminaries of peace with France were signed October, 1801, at London, and the definite treaty at Amiens, on the 27th March, 1802. The restriction on cash payments expired of itself six months after that event, but though the bank declared that its coffers were well supplied with specie, and that it was anxious and ready to resume payments in cash, the Chancellor of the Exchequer, Mr. Addington, brought in a bill on the 9th April, 1802, to continue the restriction till the 1st March, 1803, which was passed. The arguments alleged in favor of this measure, shew a wonderful decline in financial knowledge in the government of 1802 compared to 1696. At the latter period, the great reason alleged for the reformation of the coinage, was the adverse condition of the foreign exchanges, and the rise of the market above the mint price, caused by the depreciation of the currency. Notwithstanding the vehement opposition of the enemies of the government, we have seen the triumphant success of the re-coinage, which restored the public credit and the exchange. The sagacity of a Montague would at once have seen that the adverse state of the exchange and the high price of bullion were entirely

* Thoughts on the Effects of the Bank Restriction, 1803.

owing to the depreciated state of the currency, and that the only method of restoring them to par, was the immediate resumption of cash payments. So great, however, was the ignorance upon the subject, that the fact of the exchange being adverse was the very reason alleged why cash payments should *not* be resumed! Sir R. Peel said the course of exchange was at this moment against us all over Europe. Mr. Addington in bringing in the bill, said,

“ It cannot be necessary for me to inform the house that the rate of exchange between this country and foreign parts is disadvantageous to ourselves—that the export trade has been for some months at a stand, that while the rate of exchange is disadvantageous to us *an augmentation of the circulating cash* would create a trade highly injurious to the commerce of this country. *For several months past there has been a trade carrying on for purchase of guineas, with a view to exportation.* It is on these grounds that I submit to the House the expediency of continuing the restriction with regard to the cash payments of the bank.”

Why, these were the very reasons why a return to cash payments should have been made without delay! The reason why the trade of buying up guineas was going on was just because of the redundant quantity of paper; the paper “promises to pay” were falling in value as compared to the guineas, and as a necessary consequence, guineas were exported, and so far from a return to cash payments augmenting the circulating medium, it would infallibly have considerably diminished it by making the Bank reduce its paper issues. It was because the prices of articles were so high in this country that the export trade was unprofitable, and a reduction of the Bank notes would infallibly have compelled such a reduction in prices, as would have facilitated the export.

47. The result of this extraordinary amount of financial error could have been easily predicted. The circumstances of the country did not improve, as the ministry had taken the most effectual measures to prevent them doing so. In February, 1803, Mr. Addington

had to come forward again to prolong the restriction. He said that the reasons which suggested it were too strong, and the necessity too urgent to be resisted.* The restriction was continued last session, because the exchanges were adverse—the exchange with Hamburg was then at par—that with Amsterdam adverse. Upon these grounds, he said it was expedient to continue the restriction, until the progressive advance of our commerce would produce such a steady inclination of the exchange in our favour, as to render it safe to resume cash payments. That the scarcity of the last three years had made it necessary to export twenty millions of bullion in payment of corn, and until that came back, cash payments could not be resumed. Mr. Fox said that such a mode of arguing went to establish it as a general axiom that whenever the exchanges were adverse, cash payments of the Bank ought to be suspended; and then he touched the right point. “Perhaps even it might happen that the unfavourable turn of the exchange against this country *might be owing to the very restriction on the Bank.*† And he said—

“In 1772 or 1773, when there was a great quantity of bad money in the country, the course of exchange was then also much against us, but when in the room of this adulterated money good gold was substituted, the consequence was that the exchanges turned almost immediately in our favour. As long as our currency continued bad, the exchange was against us, so it is now, *because paper is not much better than bad gold*; as it is attended with the same inconveniences. May it not, therefore, be expected that as in the former case, when our currency was ameliorated, the course of exchange turned in our favour, so also if the Bank now resumed its cash payments, the same favourable circumstances might attend the change?”

48. The trace of truth thus hit upon was not followed up. And the peace having come to an abrupt end in 1803, the restriction was continued. We find it stated‡ that the hoarding of guineas had been going on

* Parl. Hist. Vol. xxxiv. p. 1147. † Ibid p. 1151.

‡ By Mr. Jekyl. Parl. Debs. Vol. i. p. 1572.

to such an extent, that it was with the utmost difficulty, that they could be procured for the common purposes of life. The Chancellor of the Exchequer talked of the baseness of such a practice, which was inconsistent with public spirit, and the duty of a good citizen. Precisely the same language had been held by the revolutionary leaders in the tribune of the French Convention regarding assignats. The debate in the Lords produced some excellent speeches. Lord Grenville, who had been of the cabinet who proposed the suspension originally, now gave very evident signs that his opinion was very much altered, and severely censured the attacks of the Chancellor of the Exchequer upon those who preferred to keep their guineas at home. Lord King now gave the clearest enunciation to the principles of a paper currency, which had before been rather feebly hinted at. He said—*

“The natural and only true limit of every paper currency was the power of compelling payment in specie, at the will of the holder. A paper currency not convertible into specie, had no rule or standard except the discretion of the persons by whom it was issued. To determine the quantity of currency necessary for circulation was in all cases a difficult and delicate problem. *A very strict attention to the price of bullion, and the state of the foreign exchanges, was alone capable of affording a just criterion by which the quantity could be truly ascertained.* Without a perpetual reference to these tests it was impossible to maintain the full value of the currency. That the Bank directors had failed in the performance of this duty was evident, from the enormous increase in the quantity of their notes, and the great derangements which had taken place in the price of silver and the foreign exchanges since the period of the restriction. He said that the excessive quantity of Bank notes, by raising the market price of silver above the mint price, was one of the causes of the present scarcity of the silver coin.”

49. The facilities of communication with the metropolis, even in that age which we are now accustomed to consider as slow, as compared with our own, were sufficient to prevent any depreciation of a local currency in Great Britain, at least since 1765, when the Scotch

* Parl. Debs. Vol. i. p. 1836.

notes were depreciated, on account of certain conditions they contained impeding their payment in gold on demand. But Ireland, from the distance of the sea passage, and the difficulty of access, might be considered as a foreign country, which resemblance was further promoted by its having a currency of its own, distinct from that of Great Britain. The Irish shilling in those days contained 13 pence, and as the pound, both English and Irish, was 240 pence, a slight calculation will shew that £100 English=£108 6s. 8d. Irish. Hence, the par of exchange between England and Ireland was called eight and one-third.

50. Although there was no run upon the Bank of Ireland, and the exchange with England was favorable, and bullion was flowing in, the Bank of Ireland was directed by Parliament to suspend its payments in cash at the same time as the Bank of England, and an Act was passed by the Irish Parliament containing analogous provisions to the English Act.

51. Ever since the year 1794, the exchange at Dublin on London had been uniformly in favor of Dublin, standing usually about £7 10s. In the first three months of 1797, it rose so high as £6 14s. 9d.; and in the second three months it rose to £6 7s. 2d.; and in the third period of three months, it attained the very great height of £5 18s 10d ; the highest it stood at on any day being £5 10s.* From that period it began steadily to decline, and it continued to fall progressively through each year, until in January, 1804, it reached the extraordinary depression of £18. No guineas were to be had for Bank of Ireland notes, except at a premium of 2s. 4d. or 2s. 6d. This enormous depression was noticed by Lord Archibald Hamilton, on the 13th Feb. 1804, in the debate on the Irish Bank Restriction Bill. He stated that when the restriction Act passed, the issues of the Bank of Ireland were £600,000, whereas now they were

* Report on the Irish Currency, 1804. p. 153.

£2,700,000. He said that between Dublin and Belfast, though not more than 100 miles apart, there was a difference in the exchange of 10 per cent.,* and that in the exchange with London, it was sometimes as much as 20 per cent. against Dublin. That gold coin rose in value just in proportion as paper was depreciated.

52. This great disorganization of the monetary business between the two countries, at length excited the serious attention of Parliament, and on the motion of Mr. Foster, a committee was appointed "to inquire into the cause of the present high rate of exchange between Great Britain and Ireland, and the state of the currency in the latter kingdom."

53. The circumstances which gave rise to the appointment of this committee and its report, are deserving of great attention, as they are the first regular investigation by parliament into the theory of the paper currency, and they were the antetype of what afterwards occurred in England, and gave rise to the appointment of the bullion committee.

54. The Bank of Ireland sent two of its directors over to be examined as witnesses, Mr. Colville and Mr. D'Olier. Mr. Colville stated that the issues of the Bank notes at the time of the restriction were between £600,000 and £700,000, but they were now about £3,000,000; and when asked the motives for such an extraordinary increase, said that the exchange became extremely adverse about two years after the restriction, the money of the country was carried out of it, for the purpose of paying the balances of remittances, and, consequently, as the medium of gold decreased *it became necessary to supply its place with paper*. He said that after the restriction, it was necessary to supply notes for the payments that would have been made in guineas, and this amount he placed at £1,200,000. He admitted† that before the restriction, whenever there was a drain of gold from the

*Parl. Debs. Vol. i. p. 1083. † Report on Irish Currency, p. 103.

Bank, they were in the habit of diminishing its issues to strengthen themselves against the continuance of the drain. That whenever the exchange was unfavorable, the necessity for self-preservation compelled them to reduce their issues, and that this limitation was for the purpose of lessening the drain of guineas. But he said that it was generally thought that the extension of paper in Ireland was the cause of the high exchange, but in his opinion it was directly the reverse, inasmuch, as far as the circulation of paper has supplied the circulating medium, it enabled the gold which before stood in its place to be exported out of the country, and so far was a clear and decided cause of preventing the exchange getting to a higher pitch; and he said that it must appear that his opinion was that the circulation of Bank paper in Ireland was in no shape the cause of the high exchange. He said that he clearly and decidedly considered the sole cause of the high rate of exchange to be that Ireland owed a great deal more money than she could pay. He considered the true criterion of such balance of debt to be the state of exchange between Dublin and London, and London and Dublin. That when the exchange was considerably above par, it was said to be against Ireland, and in that case, certainly at that time, Ireland owes more money than she is able to pay. Mr. Colville repeated these opinions several times, more often than it is necessary to quote. When pressed with the question whether the rates of exchange might be influenced by the value of the medium in the which the balance of debts was paid, as, for instance, if it were paid in degraded or adulterated coin, he admitted that it might be so with respect to *coin*, but he denied that such views in any way applied to the Bank of Ireland paper. Mr. D'Olier coincided with these views, and attributed the state of the exchanges to the same causes. When asked whether it was possible,* in any case whatever, for there to be

* Report on Irish Currency, p. 136. Ibid, p 106.

such an augmentation of inconvertible Bank paper as to diminish its value in exchange for goods, although the confidence that they might be paid off at some remote and indefinite period might be maintained, he said he thought it possible, but not probable. He said, "I have heard it stated that because gold is bought at a premium, that, therefore, Bank of Ireland notes are by so much depreciated and at an absolute discount as to the amount of that premium. That was not the proper way to look at the question. The circulation said to be depreciated must first be proved to have become burdensome to the holders, and bargains to have been made by unnecessary purchasers to get rid of that which they found inconvenient, or were apprehensive to hold. The mere buying of gold at an advanced price beyond that of the mint, is the effect, and not the cause of the exchange, and, therefore, no proof of the depreciation of the paper itself." As both these witnesses maintained that the exchanges might be depressed to any extent by the mere fact of debts being due by the country, it is much to be regretted that the committee did not ask them if it were possible in their opinion, for the exchange to be depressed beyond the limit of the expense of the transmission of bullion, and, if so, how it could be possible?

55. The description given by the witnesses of the state of the metallic currency was most astonishing.* Mr. D'Olier had some of it weighed. The base currency took about 126s. to the pound weight; the mint silver which was in circulation, was very scarce and very much worn, contained 94s. 6d. to the pound weight, whereas, when new from the mint, it contained 62s. to the pound weight. Of the base shillings, the best did not contain more than 6d., and the worst about 3d. These base pieces were coined and sold privately to agents who had the means of circulating them, at 28s. to 35s. the guinea. When such was the state of the metallic currency in

* Report, p. 88.

Dublin, the provinces in the south were even worse off. One witness stated that the silver currency had totally disappeared from the southern parts,* that the vacuum was supplied by silver notes; that these silver notes had driven out the whole of the silver currency, and from their increased amount, as well as the increasing issues of private bankers' notes of every other description, prices had risen greatly. That the bad currency had been increasing most mischievously during the last twelve months, that there was still a very good supply of good silver in the south which was hoarded on account of these silver notes, but if they were suppressed, it would come into circulation again. He said all sorts of traders as well as bankers, issued notes for 3s. 9½d. and 6s., payable at twenty-one days after date. He thought that the increase of the paper circulation augmented the state of exchange against Dublin. That the premium on guineas was a proof of the depreciation of the Bank notes; and that as the exchange rose the depreciation continued. That the premium on guineas was then 7 or 8 per cent. He himself had bought large quantities of guineas at a premium of 2s. 6d. each. In the north of Ireland, however, all bills were payable in gold; they would have nothing to do with any paper currency, and while the exchange on Dublin was 16 (7 two-thirds below par) the exchange on Belfast was 7 or 8 per cent. (one third above par). He argued that since the exchange in gold was favourable to Ireland, the real exchange must be in her favor, and that if any considerable quantity of gold came into circulation, it would at once tend to diminish the premium on guineas, and lower the rate of exchange. However, he thought that the high state of the exchange was a clear proof that the balance of payments was against Ireland annually. While no Bank of Ireland or private bank notes could be exchanged for guineas, except on paying a premium of 2s. 6d. each,

* Evidence of Mr. Roach, p. 91.

Bank of England paper bore exactly the same premium as guineas, and were received in every transaction as equivalent to guineas. And yet the directors of the Bank of Ireland maintained that their notes were not depreciated!

56. In the north of Ireland, where nothing but gold was current, and paper was tabooed, the exchange at Belfast with London had always continued favourable to Belfast, and even while the exchange at Dublin was progressively sinking, the exchange at Belfast continued to rise; thus the state of the exchanges during the years 1803 and 1804, when the committee were appointed, was as follows:—*

1803	Dublin.	Belfast.
Average of 1st quarter....	£11 1 9	£7 12 6
2nd	13 8 11	8 8 8
3rd .. .	15 17 0	7 12 6
4th .. .	15 8 7	5 12 6
1804		
January 27th	18 0 0	6 0 0

There was, therefore, at that time, a difference of 12 per cent. between the exchange at Dublin and at Belfast. Consequently, if the opinions of the directors of the Bank of Ireland were true, enormous payments were being made from Dublin to London, and a balance of payments were due from London to Belfast. However, Mr. Marshall, the Inspector-General of imports and exports, at Belfast, held a very different opinion with respect to Irish bank notes, for he appends to the table of exchanges prepared by him, this note—

“ It has certainly been heretofore held as a maxim of commerce, that the balance of trade has in a great measure regulated the rate of exchange; and if specie was equally in circulation in England and Ireland as formerly, the criterion would no doubt still be tolerably just. *But the issue of paper in Ireland is so great as to make it subject to a heavy discount, whilst in England it circulates without*

* Report p.p. 159, 183.

any depreciation at all. *I imagine the rate of exchange between the two countries therefore, is very much influenced by the rate of discount on Irish bank notes."*

57. It is scarcely necessary to observe that if the opinion of the directors of the Bank of Ireland was true that the rate of exchange at Dublin on London was due entirely to the heavy debts due from Ireland to England, their townsmen must have been great simpletons to purchase bills on London in Dublin, at such an enormous sacrifice, when they could have got them at Belfast 10 to 12 per cent. cheaper. But it appeared that specie was at a premium of 10 or 12 per cent. in Dublin, so that the bills when paid for in *cash* were exactly the same rate in Dublin and Belfast.

58. In order to test the *fact* that the rate of exchange was due to the excess of payments owing by Ireland, the committee had evidence on the subject, and it appeared most decisively that so far from the balance of payments being against Ireland, there was a very large balance in her favour. The witnesses* differed as to the precise sum, but they agreed as to the fact of there being a large sum due to Ireland, and consequently that the exchange ought to be in her favour, *which was precisely the case at Belfast where payments were made in specie*. With this incontrovertible evidence before them, the committee did not hesitate to express their conviction that the real balance of pecuniary transactions was greatly in favour of Ireland, and consequently the real exchange was and ought to be under par, and that they felt themselves compelled to seek in other causes than the balance of debts for the unfavourable exchange then existing between them.

59. We have already seen that when in 1696 the silver coinage was being recoinced, a difference arose between Bank notes and specie of 20 per cent., and between tallies and specie of 40 per cent., it was universally said that Bank notes and tallies were at a discount of 20 and

* Mr. Puget, p. 213.—Mr. Marshall, p. 123.

40 per cent. There is no trace of any other language but that being applied to them. In the year 1804 Irish Bank notes were exchanged for specie at a difference of 10 per cent., so that with a guinea in specie, any one might purchase a guinea note and 2s. or more in silver. The merchants of 1696 would have expressed such a state of things by saying that the note had fallen to a discount of 10 per cent. But at this period a new mode of expressing it was discovered, it was stoutly maintained that it was not the paper which was depreciated. but the guinea which had risen in value ! Thus, one witness being asked, "Do you know that the Bank of Ireland paper is depreciated ;" said, " I am not aware of it, because I should not say paper was depreciated, unless there was a forced issue of it, and that it was offered at a discount on all occasions. I should rather now say that gold is increased in value than the paper is depreciated." When asked, "What do you consider to be the best criterion of the depreciation of paper currency, an alteration of its value compared with the general property of any country, or its alteration compared with a given article, viz.; guineas ?" He says, "I think the first the best criterion, because guineas may be wanted, as in the present case, for special purposes." It is somewhat surprising that the witness did not remember that Bank notes are a "promise to pay" guineas, and they are not a promise to pay another kind of property. When asked "Do you not conceive that the fact of a premium existing on English Bank notes in Ireland and exchanged for Irish bank notes, affords some indication that it is Irish paper which is depreciated, and not the price of gold which is locally raised ?" "I do not."* Other witnesses agreed in these opinions. When we consider the nature of an exchange, and the state of facts proved with regard to the Irish coinage, at that time, we might almost smile at these ideas, and attribute them to the peculiar methods of thinking which are

* Evidence of Mr. Harman, p. 43.

sometimes prevalent on the western side of St. George's Channel. But we shall find that when a precisely similar state of things took place in England, with regard to the foreign exchanges, the very same doctrines were long and stoutly asserted by a very numerous party in this country, and would probably be so again under similar circumstances.

60. There was one witness, however, who held very different opinions—Mr. Marshall, the Inspector General of Imports and Exports. He said that there were shops in the principal streets of Dublin for buying and selling guineas, and that the retail price of a guinea then was a paper guinea and 2s. 2d. He said that at the end of December 1803, the price of a bill in Dublin upon London for £100 British was £116 10s., if bought with Irish Bank notes, but if purchased with specie the price was only £106 10s. Irish. The same thing was observable in all domestic transactions. The man with a gold guinea in his pocket, going to market, had the advantage of the same premium over the man with the paper guinea, so he could go to a specie shop, and with his gold guinea buy a paper guinea and the premium; then he had a paper guinea of the same value as the other man, and the premium besides. Bank of England notes were exactly equivalent to guineas. From all these facts, it appeared that the Irish Bank note wanted 10 to 12 per cent. of the value of the specie. It was contended that this was due to the rising in value of specie, and not to the depreciation of notes; but if specie had risen so much in value, or which was the same thing, if commodities had fallen so low as 10 or 12 per cent., such a state of things could not have continued for any length of time, because such a degree of cheapness would have attracted specie from great Britain, where it had not risen. Moreover, Bank notes had been issued at par with specie, at its current value, whatever it was, and they ought to have risen *pari passu* with it, so as to be exchangeable with it, and therefore whatever they wanted

of this exchangeable property must be considered as a falling off from their original value, or a depreciation to that extent. And, therefore, he was clearly of opinion that the Irish paper currency was depreciated.

61. After shewing that the balance of payments had been for a long series of years favourable to Ireland, but that the exchange had never ceased to be greatly depressed, he was asked—*

"Do you also mean on the whole of your evidence to give it as your decided opinion, that there is and has been a depreciation in the paper of currency of Ireland, and that the high rates of exchange, which have prevailed and still prevail, have arisen from that depreciation?"

"I do; the high exchange in Dublin which has now continued for some years MUST, NO DOUBT, HAVE ARISEN, LIKE ALL OTHER PERMANENTLY HIGH EXCHANGES WHICH HAVE EVER EXISTED, FROM THE DEPRECIATED STATE OF THE CURRENCY WITH WHICH BILLS OF EXCHANGE ARE PURCHASED, and the same remedy might perhaps be resorted to with success in the present case, which has never failed to be effectual on all former occasions, namely, a removal of the depreciation."

These are the ideas of the men of 1696; we shall find a long dreary period elapse before their truth was again generally recognised in this country. The amazing absurdity of supposing that the exchange could have fallen to 118, on account of the balance of payments alone, can be easily shown. We cannot suppose that the cost of transmitting the specie from Dublin to London could have been more than £2 at most. Consequently as £108 6s. 8d. was the par of exchange, if the rate of exchange fell below £110 6s. 8d. it would have been cheaper to send the specie itself. Surely, the Irish would never have been so foolish as to pay £118 in Dublin to purchase a debt in London of £100, when they could place the cash itself on the spot for £110 6s. 8d.

62. The Directors of the Bank of Ireland had admitted that before the Restriction Act, they were obliged to regulate their issues of paper by the price of guineas, and

* Report, p. 122.

the exchange with London. Whenever they had an unusual demand for guineas, and the exchange was adverse, they had been obliged to diminish their issues to prevent the continuance of the demand for guineas. As soon, however, as they were released from paying in cash, they no longer thought themselves bound to follow the same rules, and we have seen how prodigiously they had extended their issues. They admitted, however, that it was a possible case, that their issues might be too great, and a new theory was now advanced which we discussed at some length in a former chapter, but we notice it now because this appears to have been the first occasion it was propounded by mercantile men. Mr. Irving, being asked if in his opinion, Irish Bank notes were depreciated, said that he did not think so, although guineas were selling at a premium.

“Explain your reasons.”

“I am of opinion that a bank managed with prudence would only issue notes in proportion to the demand which may be made for those notes, in exchange for good and convertible securities, such as mercantile bills of exchange payable at specific periods, of undoubted respectability, founded upon real mercantile transactions, upon government securities such as exchequer bills, in the purchase of Spanish dollars, or other bullion, and the circumstances of the bank notes of Ireland being demanded for such good and convertible securities, I am of opinion, is a proof that they are not too large in amount, and that their value is not depreciated.”

We shall see afterwards that this theory was adopted by the directors of the Bank of England. It is one quite opposed to that by which the Irish directors acknowledged themselves obliged to follow whilst they were liable to pay their notes in gold. Hence, if it was correct it inevitably followed that the issues of a bank should be governed on totally different principles under a convertible and an inconvertible paper currency.

63. After accumulating a considerable body of evidence upon the subject, and examining witnesses of all sorts, of various opinions, and various professions, the

committee reported that the real exchange was in favour of Ireland, and that the difference between the real and nominal exchange arose from the depreciation of the Irish paper. They pointed out the absurdity of supposing that the value of gold had risen, and not that the paper was depreciated.* They said that the difference between the rate of exchange could never vary more than the cost of transmitting specie from one to the other, and that any excess above that could only arise from other causes. They then noticed the enormous increase of the paper currency that had taken place, since the only check against over-issue was removed, namely, convertibility into gold at the will of the holder,—the great quantity of base and counterfeit coin fabricated and forced into circulation,—and shewed that under an unfavourable state of the exchange, the paper currency had always been diminished. “If prudence had not dictated such a course, necessity would have compelled a diminution of issues, by diminishing the stock of specie, which could only be replaced at a loss proportionate to the existing rise of exchange, and your committee observe that in fact as well as in theory, the result of such practice always was and must be the redress of the unfavourable exchange.”† Since the Restriction Act, however, the Directors had acted exactly upon the opposite principle; when the exchange was unfavourable, they had greatly increased their issues. Excessive issues of paper produce a proportionate rise in the rates of the exchange, for these are obviously influenced by the value of the medium in which the payments are made, and the *quantity* of that medium necessary to effect a given payment must be increased as the value of the medium diminishes, no matter whether the payments be made in a degraded and adulterated coin, or in a depreciated paper.‡ If paper by depreciation comes to represent a less quantity of money than it professes to do, it must make the

* Report, p. 4.

† Ibid, p. 7.

‡ Ibid, p. 1.

exchange which it is to pay, appear unfavourable, in the same manner as coin in which it were to be paid would have done, if by degradation it should cease to contain the same portion of gold which it used to do; and the removal of the degradation in the one case, and of the depreciation in the other, would have the same effect in bringing the exchange to par, or whatever might be its real state.

64. After recommending several minor remedies, the committee said, "But all the benefits proposed by this mode of remedies would be of little avail, and of very limited duration, if it did not promise at the same time to cure the depreciation of paper in Ireland by diminishing its over-issue. * * * And your committee do, in express terms, declare their clear opinion, that it is incumbent on the directors of the Bank of Ireland, and their indispensable duty, to limit their paper at all times of an unfavourable exchange during the continuance of the restriction, exactly on the same principle as they would and must have done, in case the restriction did not exist, and that all the evils of a high and fluctuating exchange must be imputable to them if they fail to do so."

65. They then noticed the miserable state of the silver coinage, or rather the base metal, and notes, and I O. U's substituted in its place, which they said was clearly to be traced to the unfavourable exchange. As long as the exchange continued in that unfavorable state, all the genuine silver coin transferred itself to England, and the place of the genuine silver coin was supplied by these small silver notes in the country districts, and in Dublin, where they were not issuable, by an extremely base silver coinage, which was privately fabricated in great quantities, all of which evils could only be cured by the restoration of the exchanges to their true state, and the issue of a genuine silver coinage.

66. The committee contented themselves with declaring in the most emphatic terms, that the Bank of

Ireland ought to regulate its issues by the state of the exchanges, but it did not discuss the new theory propounded, that the paper currency should be regulated by the mercantile bills of exchange offered for discount. No one who has paid any attention to the principles of the subject, and carefully considered the facts produced before the committee can fail to acquiesce in their judgment, and we cannot fail to remark that none of the professional witnesses, *i. e.*, the directors of the Bank of Ireland, or the other bankers examined, had attained the smallest glimpse of the principles which governed their own business, and by which they should have directed their policy. Its true principles were clearly seen and announced solely by the extra-professional witnesses, and laid down by the statesmen who formed the committee. We may suppose that fear of giving offence to their customers, and so diminishing their business and profits, may have somewhat dimmed their perception.

67. As it was evident that as long as the different currencies between the countries continued, there must be an exchange from the want of a common medium of payment, the committee strongly recommended that the monies of circulation and account should be assimilated, and that Bank of Ireland notes should be payable in Bank of England paper, and that the Bank of Ireland should establish a fund at their credit in London for that purpose, and that all bills should be payable at a fixed date, which measures had been found to reduce the Scotch exchanges to par, and maintain them so ever since the year 1763, through all the political and commercial convulsion of the period.

68. The presentation of this Report does not seem to have excited any discussion in the House till many years afterwards. In 1809, Mr. Parnell moved that the currencies of England and Ireland should be assimilated in accordance with the recommendation of the committee,

which was rejected without a division.* The Report does not seem to have been printed for public circulation till 1826; but it was probably communicated to the Bank, and produced some effect upon their policy. A fact was stated by Mr. Foster, in the House, † that in the months of May, June, and July, 1804, the directors diminished their issues from three to two millions and a half, and the exchange rose; in August they increased them again, and the exchange fell. The Chancellor of the Exchequer (Addington) declared that it was a perversion of terms to infer that the depreciation of paper had any real effect on the exchange. The excessive issue of paper might produce a depreciation, but each country had a different circulating medium, and the depreciation of either could only have a nominal effect on the course of exchange. Mr. Addington wholly overlooked the fact that payments were made in Bank of Ireland paper, and the course of exchange referred to that paper. If payments had been made in silver coin of full weight, then it would have been true that the exchange would not have been disturbed by the depreciation of the paper. But the course of exchange always relates to the medium in which the payment is actually made, and a depreciation of that medium necessarily causes an adverse state, in whatever state the other parts of the currency may be, which are not the medium of payment. Of this we have seen a conspicuous instance in 1696, when the restoration of the silver coinage immediately rectified the exchange, although Bank paper continued to be depreciated long afterwards. Mr. Fox, with premature exultation, said ‡ that he was glad to hear that the Chancellor of the Exchequer allowed that an excessive issue caused a depreciation, and that the House was never again to hear *the fantastical opinion that the paper was not*

* Parl. Debs. Vol. xiv., p. 75.

† Ibid. Vol. iv. p. 69.

‡ Parl. Debs. Vol. iv., p. 70.

depreciated, but the value of gold raised. Had Mr. Fox been able to look forward only six years, he would have found that this fantastical opinion not only re-appeared, but was maintained with more stubbornness and pertinacity than ever.

69. Such was the occasion of the first declaration by a parliamentary committee, of the principle that the issues of the bank should be regulated by the foreign exchanges, a committee comprehending almost all the great names of the different parties of all opinions. As it was not then the custom to publish the lists of the divisions in committees, we are not able to say whether they were unanimous on the subject; but from the exceedingly strong and decisive language of the Report, we may fairly infer that the opinion of the committee was equally strong and decided, and that if a minority differed from the resolutions of the majority, it must have been a very small one.

70. After the temporary disarrangement of the market or paper price of gold in 1801, it gradually became better, as the circumstances out of which it arose passed away. And for several years the bank note did not vary much from par. But about the year 1809, one of those great phrenzies of commercial speculation which occurred in 1694 and 1720, again seized the nation.* The Bank of England extended its accommodation to persons of notoriously insufficient capital, to most imprudent lengths. Immense multitudes of country banks started up in all directions, fanning speculation, and inundating the country with their notes, exactly as they had done before 1793. In 1797 they were reduced to 270; in 1808 they had increased to 600; and in 1810, when the bullion committee were appointed, they amounted to 721; and the quantity of paper they had in circulation was supposed to amount to £30,000,000. At the same time the Bank of England increased its issues to £21,000,000.

* For fuller details, see Theory and Practice of Banking. Chap. ix.

71. Concurrently with these extravagant speculations and issues of notes, the price of gold bullion rose rapidly, and the foreign exchanges fell with equal rapidity, exactly the same symptoms as had been manifested in Ireland in 1804. And it was observed that the gold currency disappeared suddenly from circulation. The following figures taken at intervals are sufficient to shew the rapid rise of the price of bullion and the fall in the foreign exchange:

		Price of Standard Gold.				Price of Silver.				Exchange with Hamburg.	
		£	s.	d.		s.	d.		s.	d.	
Jan. 1805	....	4	0	0	....	5	4	....	35	6	
Oct. 1805	....	4	0	0	....	5	5	....	33	9	
July 1808	....	no quotation			....	5	3	....	34	9	
Feb. 1809	....	4	10	0	....	5	3	....	31	0	
May 1809	....	4	11	0	....	5	5	....	29	6	
Jan. 1810	....	4	13	0	....	5	7	....	28	6	

72. Under these circumstances, Mr. Horner, on the 1st February, 1810, moved for several accounts relating to currency and exchanges. Mr. Baring stated that guineas then brought 26s. or 27s. A few days afterwards the bullion committee were appointed.

73. After the full and minute account we have given of the derangement of the Irish currency in 1804, we need not go into any details of the bullion report.* It is sufficient to say that the committee declared that this great rise in the market or paper price of gold, was owing to the depreciation of the home currency from inordinate increase, that, in fact, bank notes were at a heavy discount. That the Bank of England should regulate its issues by the foreign exchanges exactly as it had done before the restriction, and that to restore the bank note to par there was no effectual method but to compel the bank to resume payments in cash.

* A full analysis of the Bullion Report is given in my Theory and Practice of Banking. Chap. ix.

74. As on this occasion, a division of opinion manifested itself on these financial questions, which seems to be as permanent and deep seated as the divisions on political questions, it may be of advantage to state shortly and precisely the points upon which the respective parties were at issue. The facts of course were easily ascertained and agreed upon. They were as follows:

- I. That the mint price of gold bullion or the legal standard of the coin was £3 17s. 10½d. per oz.
- II. That the market price of gold bullion was then £4 10s. per oz.
- III. That the foreign exchanges had fallen to an enormous extent; that with Hamburg 9 per cent., that with Paris 14 per cent.
- IV. That the increase of bank notes had been very great during the last few years, and was rapidly augmenting.
- V. That specie had disappeared from circulation.

75. Upon this acknowledged state of facts the opposite issues maintained by the two parties, were as follows:

The one party maintained—

- I. (a) That the Bank notes were depreciated.
(b) That the difference between the market price and the mint price of gold bullion, was the measure of the depreciation.
- II. (a) That the extreme limit to which the foreign exchanges could by the nature of things fall, in any case, was defined and easily ascertained, and consisted of the expense of freight, insurance, and some other minute causes.
(b) That in the then state of the exchanges there was a very large excess of depression over and above that limit, which was not attributable to any of these causes.
(c) That this residual depression of the foreign exchanges, and the rise of the market price above

the mint price, was caused by the excessive issues of bank notes in circulation.

III. That a diminution in the quantity of bank notes would increase the value of the domestic currency—would cause the foreign exchanges to rise to par—and the market price of gold to fall to the mint price.

IV. That the Directors of the Bank of England ought to follow the same rules in the extent of their issues during the restriction of cash payments, as they were obliged to do before, viz., by regulating them by the foreign exchanges. When the exchanges were favourable, and bullion flowing in, they might enlarge them; when the exchanges were adverse they must contract them.

76. In opposition to these principles, the other party maintained,—

I. (a) That it was not the Bank notes that were depreciated, but the price of specie that had risen.

(b) That there was no difference between the price of bullion, whether paid in notes or specie.

II. That the depression of the foreign exchanges was in no way whatever attributable to the depreciation of the currency, but was entirely caused by the adverse balance of payments to be made by Great Britain, the remittances to the army, the continental measures of Napoleon, and other political measures.

III. That no diminution or increase of the issues by the Bank would have any effect whatever upon the foreign exchanges, either in raising or depressing them, or on the market price of bullion.

IV. That since the restriction, there was no necessity for observing the same rules in issuing their notes by discounts, as before, *i. e.*, by observing the course of the foreign exchanges, but that the public demand was the sole criterion, and so long as they adhered to these rules, there could be no over-issue.

77. The Report gave some statistics regarding the quantity of notes in circulation at different periods since the restriction. However, they said that the actual numerical amount of notes in circulation at any given time was no criterion whatever, as to whether it was excessive or not. Different states of trade, and different extents of commercial operations, would require different amounts of notes. When public credit was good, a smaller amount would be required than when public alarm was felt, and people had recourse to hoarding. Moreover, the different methods of doing business, and economising the use of the currency, much influenced the amount which might be proper and necessary at any period. The improved methods of business, the policy of the Bank, the increased issues of country bankers, had all tended to diminish the quantity of bank notes necessary for commerce. Consequently, the numerical amount alone was no criterion whatever; a surer test must be applied, and that sure criterion was only to be found in the state of the exchanges, and the price of gold bullion.

78. The experience of the crisis of 1793 had proved that an enlarged accommodation was the true remedy for the failure of confidence in country districts, such as the system of paper credit was occasionally exposed to. That it was true the bank had refused the enlarged accommodation in 1793. But the issue of exchequer bills was exactly the same in principle, and the good effects that followed that issue proved the truth of the principle, that if the Bank had had the courage to extend its accommodation in 1797, instead of contracting it as they did, the catastrophe which followed might probably have been avoided. Some persons thought so at that time, and many of the directors, since the experience of 1797, were now quite satisfied that the course adopted by the Bank in that year increased the public distress, in which opinion the committee fully concurred.

79. A very important distinction, however, was to be

observed between a demand for gold for domestic purposes, sometimes great and sudden, and caused by a temporary failure of confidence, and a drain arising from the unfavourable state of the foreign exchanges, *that a judicious increase of accommodation was the proper remedy for the former phenomenon, but a diminution of its issues the correct course to adopt in the latter.*

80. The Report was presented by Mr. Horner on the 9th June, 1810, but was not formally taken into consideration till 6th May, 1811. Mr. Horner addressed the House for upwards of three hours, in a speech which obtained the admiration of all who heard it; he ended by moving a series of sixteen resolutions. The first seven related to the legal standard of value in this country, with reference to which all contracts were made in this country.

8. That the promissory notes of the Bank were stipulations to pay on demand, the number of pounds sterling specified upon them. 9. That when Parliament passed the Restriction Act, it had no intention that the value of these notes should be altered. 10. That, nevertheless, they had for a considerable time been below their legal value, (11) which was caused by the excessive issues of them, both by the Bank of England and the country banks. 12. 13. That the extraordinary depression of the foreign exchanges was in great part owing to the depreciation of the currency of this country, relatively to that of other countries. 14. That during the suspension, the directors of the bank ought to regulate their issues by the price of bullion and the foreign exchanges. 15. That the only method of preserving the paper currency at its proper value, was to make it payable on demand in the legal coin of the realm. 16. That cash payments ought to be resumed at the period of two years from that time.

81. Mr. Vansittart, who moved the counter-resolutions to Mr. Horner, controverted, at great length, the principles of the report. He asserted that the only mode in which a metallic currency could have a favourable effect

on the exchanges was by *exportation*, and that if exportation was prohibited by law, no effect could be produced. This assertion, however, was sober good sense compared to the lengths of wild extravagance into which he subsequently plunged. He said that the first seven resolutions argued on the supposition that the standard was something visible and tangible. "I affirm that a standard in the sense used by these gentlemen, namely, a fixed and invariable *weight* of the precious metals as a measure of value, never existed in this country!!"* He ridiculed the idea of the resolution that the weight at which any such money is authorised to pass current is fixed!! These extraordinary ideas he attempted to support by reference to the degraded state coin had been in at different periods, but which were yet legal tender, and which he contended, proved that the coin was not any definite weight of bullion. It was upon this point, he said, that the question of depreciation depended. "Now, I do not consider myself bound either to admit or deny that Bank notes have lost a value which they never possessed, and which the legal coin of the country never possessed, namely, a value estimated by a fixed weight of gold or silver bullion. They never had any other than current value founded on the public confidence in the Bank, and this value, I firmly believe, and have distinctly stated in my third proposition, that they possess as much as ever." When the whole of the rest of his speech was a mere repetition and development of such crazy ideas, it is mere waste of time to give any more details of it. There is one more specimen, however, which we cannot refrain from extracting. He says,* "it appears, then, that a diminution of the value of currency may have the effect of improving the exchange, but cannot by possibility depress it!!" Which means, that the more debased and worthless the currency of a country is, the more favorable should be the foreign exchanges, or the higher should foreigners estimate it.

* Parl. Debs. Vol. xvi. p. 925.

So that while the French assignats were daily falling lower and lower at home, the more should foreigners have given for them ; so that while the French themselves gave one livre in coin, for 1200 in assignats, the English and other foreigners ought to have given their full nominal value in coin, and even more than that according to Mr. Vansittart. He then made several triumphant observations about there being no difference in transactions between bank notes and coin. He admitted that he had been a member of the Irish Committee of 1804, and had concurred in the opinion that Irish Bank notes were depreciated, but he said that the two cases were not parallel; for it appeared not only that the current coin was openly sold at a premium, but that an established difference of price existed between payments in coin and Irish paper, while Bank of England paper passed as equivalent to guineas. This depreciation, however, he denied had proceeded from excessive issues, but from the political circumstances of the period.

82. Such were the leading arguments against the conclusions of the committee, which though somewhat varied in expression, were constantly repeated. After the exposition given in the preceding sections of this chapter, of the various states of our coins at different periods, it would be waste of time to attempt seriously to disprove the outrageous folly of the proposition, that the coins of Great Britain never were intended to contain any fixed or certain quantity of gold or silver bullion in them. If this had been true, what was the need of having any gold or silver in them at all; if it was not to regulate their value?

83. Mr. Sharp, a member of the Bullion Committee, adduced further facts to prove that the Bank notes were depreciated; he said it had been usual to send over specie to Guernsey to pay the troops there. *Each guinea had lately been paid to the soldiers at 23s.*; one regiment, however, had refused to receive them at that rate. In another case he knew of a person who had received a

legacy of 1,000 guineas which was paid in specie, he went to invest it in the funds, and on asking the price of the 3 per cent. was told 64½. But on asking what the price would be if paid in real money, he was told, after some consideration, he might have it at 60, which was the price actually paid. So that while the government were arguing at Westminster that guineas were of the same value as Bank notes, they were at the same time dishonest enough to pay them away to the soldiers at 23s. Sir Francis Burdett also stated that he had been offered goods at far different prices, according as he should pay for them in specie, or in Bank notes.

84. When we read the arguments and evidence, which seem to be so perfectly satisfactory, according to all the usual principles that command assent, we feel some curiosity to know what was the opposing theory set up against them, and it was simply this, that the pound sterling was nothing tangible at all! It was an imaginary vision! a vague idea! an airy nothing! which never had any existence in nature at all, and that accordingly, everything, money and bullion included, might vary in endless changes round this ideal centre. It had even less substantiality than a whiff of smoke! It was "a sense of value" communicated in some mysterious way from one person to another. And this is the view maintained by a numerous party up to the present day. Mr. Canning pursued the author of this insensate folly with unsparing ridicule in his speech. He also ably pointed out the consequence of not allowing guineas to circulate at their market value, which had been followed by their total disappearance, whereas, dollars, which were beginning to disappear, when they were bound down to the value of the depreciated Bank paper, were immediately restored to circulation, when they were allowed to pass current at their intrinsic value. However, though he fully agreed in all the principles and reasonings of the Bullion Report, he did not think it expedient that the Bank should be called upon to resume cash payments

in so short a period as two years. The House of Commons then came to a solemn vote, that a £1 Bank note and seven shillings, was equal to a guinea, or 21 shillings. Or that 21 was equal to 27. Or that a £1 Bank note which professed to represent 20 shillings, was equal to 14s. Among those who came to this sage decision, was the name of ROBERT PEEL.

85. The principles of the bullion report having been decisively rejected by parliament, and pronounced to be fallacious, by the resolutions which declared 21 to be equal to 27, the Bank took no measures to bring their notes to a nearer conformity to their nominal value. When the committee were appointed the paper price of gold bullion was £4 13s., the true meaning of which is that the £1 note was worth about 16s. 8d. The market or paper price continued to rise till in November, 1813, it stood at £5 10s., the greatest height it ever reached, which gives the real value of the note as 14s. 2d. The long continuance of high prices partly caused by a continued series of deficient harvests, and partly by the depreciation of the paper in which they were paid, gave rise to the belief that they would continue permanent. Immense speculations began in land-jobbing, vast tracts of waste and fen land were reclaimed. It was, at this time, that the immense agricultural improvements in Lincolnshire were effected. Rents in most cases rose to treble what they were in 1792; all the new agricultural engagements entered into at this period were formed on the basis of these extravagant prices; landlords and tenants increased their expenditure in a like proportion, family settlements were made on a commensurate scale. As a natural consequence, country banks greatly multiplied. In 1811, they were 728, in 1815, they had risen to 940, and the amount of their issues was supposed, on the most moderate estimate, to be about £25,000,000. After the disasters of the French in the Russian campaign of 1812, and the battle of Leipsic, the ports of Russia and Northern Germany were thrown open to British commerce. This

naturally gave rise to enormous speculative exports and overtrading.

86. The harvest of 1813 was prodigiously abundant, so that the price of corn, which in August, 1812, had been 155s. and had receded gradually from that point till August, 1813, fell with great rapidity, and in July, 1814, was only 68s. The exporting speculations were at their height in the spring of 1814, and the prices of all such commodities rose to a very unusual height, in many cases to double and triple of what they had been before.* Every branch of industry was by the preceding causes affected, and the natural and inevitable consequences soon followed. A violent revulsion and general depression of prices of all sorts of property, which entailed such general and universal losses and failures among the agricultural, commercial, manufacturing, mining, shipping, and building interests, as had never before been paralleled. As is always the case, the consequences of the wild speculations and engagements persons had entered into during the continuance of the fever continued to be felt for some years after. The disasters commenced in the autumn of 1814, continued with increasing severity during 1815, and reached their height in 1816-7. During these years 89 country bankers became bankrupts, and the reduction of the issues of country paper was such, that in 1816 its amount was of little more than half what it had been in 1814.

87. This general discredit of country Bank paper resembling what had previously occurred in 1793 and 1797, caused a demand for additional issues from the Bank of England to help to maintain public credit, and though this caused an extension of the Bank paper by upwards of three millions, so great was the abstraction of country Bank paper from circulation, (to certainly three times the amount of the Bank of England issues) that the value of the whole currency rapidly rose, so that

* Tooke's Hist. of Prices, Vol. i. p. 347.

while in May 1816, the market or paper price of gold was £5 6s. the exchange in Hamburg 28.2, and that on Paris 19, in October 1816, the paper price of gold had rapidly fallen to £3 18s. 6d., the exchange with Hamburg was 38, and that on Paris 26.10, and they remained with little variation at these prices till July, 1817.*

88. Hence, at length was manifested the most complete triumph of the principles of the Bullion Report. The great plethora of this worthless quantity of paper currency being removed, the value of the whole currency was raised almost to par, so near, in fact, that the smallest care and attention would have brought it quite to par, and if means could have been taken to prevent the growth of the rank luxuriance of country bank notes, cash payments would have been resumed at this period, with the utmost possible facility, and without exciting any disturbances.

89. The partial resumption of cash payments was attended with perfect success; it caused no very great demand for gold, which continued to accumulate in the bank till October, 1817, when it reached its maximum, being £11,914,000. In that month the bank gave notice that it would pay off in cash all the notes dated before 1st January, 1817, or renew them at the option of the holders. In the course of 1817 a very large amount of foreign loans were contracted for; Prussia, Austria, and other continental states of lesser importance, were endeavouring to replace their depreciated paper by a metallic currency, and as money was abundant in England, a very large portion of these loans was taken up here. The effect of this began to manifest itself in April, 1817, when the exchanges with Hamburg and Paris began to give way, and the market price of gold to rise. These phenomena increased gradually throughout 1818, until in January, 1819, the price of gold was £4 3s., the exchange on Hamburg 33.8, and that on Paris 23.50. In July,

* Commons Report on the Resumption of Cash Payments, 1819. p. 309.

1817, the new gold coinage began to be issued from the Mint in large quantities. The consequence was a steady demand for gold set in upon the bank, and in pursuance of its notices the sum of £6,756,000* was drawn out of it in gold. Just at this time the British Government reduced the rate of interest upon Exchequer bills. The much higher rate of interest offered by continental governments caused a great demand for gold for exportation, and in the beginning of 1818 a very decided drain set in. The Bank directors, however, determined to set all the principles of the Bullion Report ostentatiously at defiance. While this great drain was going on, they increased their advances to government from £20,000,000 to £28,000,000, and though they knew perfectly well that the demand of gold was for exportation, they took no measures whatever to reduce their issues for the purpose of checking the export. At the same time the issues of country banks had increased by two-thirds since 1816.

90. This demand for gold became more intense during 1818 and 1819, and it became evident that the bank would soon be exhausted if legislative interference did not take place. Accordingly on the 3rd February, 1819, both Houses appointed committees to inquire into the state of the bank; and on the 5th April they reported that it was expedient to pass an Act immediately to restrain the bank from paying cash in terms of its notices of 1816-7. An Act for that purpose was passed in two days' time. It was stated in the report of the Commons that in the first six months of 1818, 125 millions of francs had been coined at the French Mint, three-fourths of which had been derived from the gold coin of this country.† The Act‡ forbade the Bank to make any payments in gold whatever, either for fractional sums under £5, or any of their notes, during that session of parliament.

* Report of Commons' Committee, p. 4.

† Parl. Debs. Vol. xxxix. p. 1400.

‡ Statute, 1819, c. 23.

The Act, therefore, totally closed the Bank for payments in cash.

91. Both Houses of Parliament immediately appointed committees to inquire into the subject. The one in the Commons was presided over by Sir R. (then Mr.) Peel. The entire and unanimous strain of evidence of the mercantile world was now completely in favor of the opinion of the Bullion Committee, which had been so ignominiously rejected eight years before. And the current of commercial opinion converted the chairman, who introduced the bill into the House, directing that the Bank should resume specie payments at the mint price of gold, on the first of May, 1823. However, the Bank was afterwards permitted to commence paying in specie on the 1st May, 1821.

92. Immediately after the cessation of the war, the government had taken in hand the great work of a complete re-coinage, when the great principle, first discovered by Locke, was at length adopted, of having only one standard of value. During the course of the preceding century, merchants had become accustomed to consider all contracts to be made in gold, and this was now declared to be the sole legal tender. At the end of the 18th century, the relative value of gold and silver had undergone a perceptible change in the markets of the world. Consequently, the adjustment that had been made in 1717, no longer corresponded to the market value of the two metals; and if a silver coinage had been issued at the former denomination and weight, the very same effects would have followed, which had been experienced so often before; it would have immediately disappeared from circulation. In order to guard against this the power of private persons to have silver coined was taken away, and the pound weight of silver was ordered to be coined into 66, instead of 62 shillings; but of these, 4 were kept back for the expenses of coinage, and consequently only 62 were issued. The result of which is, that the present shillings pass current for rather more

than 6 per cent. above their intrinsic value. In order to prevent any injustice to individuals from this depreciation of the coinage, it was enacted that no tender of payment in silver above 40s. at any one time should be legal, either by tale or by weight. This arrangement of the English coinage has this great merit, that it allows a very considerable change to take place in the market value of gold and silver, without causing any disturbance in the currency. In France, where silver is the legal tender of the state, gold and silver are coined according to their relative market value, the consequence has been that silver has nearly disappeared from circulation. The fact seems placed beyond all question, that the prodigious additions recently made to the quantity of gold, have caused an alteration in the relative values of gold and silver. Gold has almost superseded silver in France, for exactly the same reasons as it did in England in the days of William III., and during the 18th century, namely, that gold was overrated in comparison to silver. This occurred notoriously in France during the autumn of 1856. It cannot take place in England until the difference in their relative values exceeds the artificial difference in the English coinage.

93. We have seen that when guineas were first coined, they were intended to represent 20s., and that it was owing to an error in the rating that they came to pass for 21s. On the first of July, 1817, a new gold coin was made current by proclamation, of the value of 20s., which was ordered to be called a sovereign, in imitation of the coin of that name, first issued by Henry VII. It was ordered to be of the weight of 5 dwts. 3.274 grns. of standard gold. And thus it became the British pound. When persons ask, What is a pound? The answer is very simple, it is 5 dwts. 3.274 grains of gold, 22 carats fine, and 2 carats alloy. And any bank note that promises to pay so many pounds, is a promise to pay so many multiples of that unit, and nothing else. The last coinage of guineas took place in 1813. Since this last reformation

of the coinage, no alteration that requires notice has been introduced, except the striking of 2s. pieces, called florins, to pave the way for the decimal division of the currency. But a change of this magnitude, however beneficial it might ultimately be, involving as it does a temporary derangement in affairs of such stupendous magnitude, will not easily be effected in this country.

TABLE SHEWING THE DIFFERENT VALUES FOR WHICH THE POUND WEIGHT OF SILVER AND GOLD WERE ORDERED TO PASS CURRENT, BY VARIOUS MINT INDENTURES FROM 1844 TO 1817.

(From the Report of the Commissioners appointed to inquire into the Constitution, &c. of the Royal Mint. P. 35, 1849.)

Date A.D.	SILVER. Current Value of 1lb. or Mint Price.	GOLD. Current Value of 1lb. or Mint Price.	Date A.D.	SILVER. Current Value of 1lb. or Mint Price.	GOLD. Current Value of 1lb. or Mint Price.
	£ s. d.	£ s. d.		£ s. d.	£ s. d.
1344	1 2 2	15 0 0	1553		
1345	1 2 2	13 3 4	6 inden- tures to	3 0 0	36 0 0
1346	1 2 4	13 3 4	1572		
1347	1 3 3 IN HALFPENCE		1577		
	1 3 5 IN FARTHING		1582	3 0 3	36 1 10½
	1 2 6 IN PENCE		1583		
1347	1 3 3 IN HALFPENCE	14 0 0	1593	... ..	33 0 0
1350	1 3 5 IN FARTHING		1601	3 2 0	36 10 0
1351	1 3 5 IN FARTHING				33 10 0
1352			1604	4 2 6	... ..
13 inden- tures to	1 5 0	15 0 0	1605	... ..	40 10 0
1459			1611	... ..	44 11 0
1412			1612	3 2 0	44 10 0
9 inden- tures to	1 10 0	16 13 4			40 18 4
1459			1617	3 2 0	40 18 4
1461	2 0 0	16 13 4	1623	3 2 0	44 10 0
1464	1 17 6	20 16 8			41 0 0
1465			1625	3 2 0	41 0 0
12 inden- tures to	1 17 6	22 10 0	1626	3 5 6	44 0 0
1509		27 0 0	1626	3 2 0	44 10 0
1526	2 5 0	25 2 6	1649	3 2 0	41 0 0
1533	2 5 0	25 2 6	1660		
1543	2 8 0	28 16 0	1670		
1547	... ..	30 0 0	1688	3 2 0	44 10 0
1549	4 16 0	34 0 0	1702		
1550	... ..	28 16 0	1718 to 1817	3 2 0	46 14 6
	1 16 0	... ..	1817 Now in force.	3 6 0	46 14 6
1553	2 0 0				

Table showing the chief variations in the market price of gold bullion from 1790 to 1819, and the true value of the Bank of England £1 note during the Restriction.

	Market price of Gold Bullion.	Real Value of the Bank Note.
January, 1790	£ s. d.	£ s. d.
to August 25, 1797	3 17 6	
September 1, 1797		
to October 19, 1798	3 17 10½	1 0 0
October 26, 1798		
to September 13, 1799	3 17 9	1 0 0
September 20, 1799		
to April 6, 1804	No quotation.	
April 13, 1804		
to October 15, 1805	4 0 0	0 19 6
October 22, 1805		
to October 2, 1810	No quotation.	
October 9, 1810	4 5 0	0 18 4½
February 12, 1811	4 12 0	0 16 11½
March 26, 1811	4 16 0	0 16 3
October 25, 1811	4 18 0	0 15 11
October 2, 1812	5 7 0	0 14 5
January 22, 1813	5 4 0	0 15 0
August 6, 1813	5 10 0	0 14 2
February, 1814	5 8 0	0 14 4½
April 12, 1814	5 5 0	0 14 9
May 31, 1814	5 3 0	0 15 1½
June, 7, 1814	5 0 0	0 15 7½
June 28, 1814	4 10 0	0 17 4
September 20, 1814	4 6 0	0 18 1½
November 15, 1814	4 8 0	0 17 8½
April 4, 1815	5 7 0	0 14 5
June 9, 1815	5 5 0	0 14 10
June 30, 1815	5 0 0	0 15 7½
July 7, 1815	4 14 0	0 16 7½
August 4, 1815	4 10 0	0 17 4
September 15, 1815	4 9 0	0 17 6½
October 13, 1815	4 3 0	0 18 9½
January 2, 1816	4 2 0	0 19 0½
April 9, 1816	4 1 0	0 19 3½
April 23, 1816	4 0 0	0 19 6
July 9, 1816	3 19 0	0 19 8½
October 8, 1816		
to April 4, 1817	3 18 6	0 19 10½
April 18, 1817		
July 18, 1817	3 19 0	0 19 8½
January 23, 1818	4 0 0	0 19 6
February 13, 1818	4 1 0	0 19 3½
October 6, 1818	4 2 6	0 18 11
January 22, 1819	4 2 0	0 19 0½
	4 3 0	0 18 9½

CHAPTER VII.

ON THE REGULATION OF A PAPER CURRENCY.



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ON THE REGULATION OF A PAPER CURRENCY.

IMPORTANCE OF THE SUBJECT.—POLICY OF THE BANK IN 1783—IN 1793—IN 1797—IN 1818—IN 1825—IN 1838.—ALL THEORIES OF PAPER CURRENCY MAY BE REDUCED TO THREE VARIETIES—LORD OVERSTONE'S DOGMA ON THE "CURRENCY PRINCIPLE."—SIR ROBERT PEEL'S THREE STATES OF OPINION ON THE CURRENCY QUESTION.—THE BANK ACT OF 1844.—ITS INCONSISTENCY WITH THE THEORY OF ITS FRAMERS—POLICY OF THE BANK IN 1847—IN 1856—IN 1857.—CONCLUSION.

1. We have in the preceding parts of this work, endeavoured to establish it as one of the most important doctrines of Political Economy, that instruments of credit, such as Bills of Exchange, Bank notes, Bank credits, &c., are separate and independent values, wholly distinct from money and commodities, and they do not *represent* money, as Bills of Lading represent goods. However, they only maintain their value through the belief and confidence that they can be exchanged for money, and if that belief or confidence fails, their whole value vanishes into air. When we consider the colossal amount of this property, which exists in modern times, consisting of hundreds of millions, the destruction of which is in every respect equivalent to the destruction of any other species of tangible property, we can at once see the amazing importance of the question, as to the best method of maintaining the value of this property, and guarding

against its liability to destruction. When we consider that the value of property in this country, which consists of credit, is at least £600,000,000 and that the cash is not supposed to exceed £70,000,000, we see that the value of the credit is somewhat, what physicists would call, in a position of unstable equilibrium. This wonderful mass of property may, if mismanaged, come to resemble what is said has taken place upon opening the tombs of some Etrurian kings. There appeared to be the form of man reposing and arrayed in his royal robes, but upon the slightest vibration disturbing the atmosphere, it immediately sunk into a few spoonfuls of dust!

2. The proper regulation, then, of the paper currency, is not only by far the most important problem in Political Economy, but one of the most important in human affairs. It sums up within itself the whole science of Political Economy. To settle it on truly scientific principles, to arrive at the true method of controlling it, demands the investigation and settlement of the meaning of every single term in the science. Hume says, that the whole end of civil government is for the administration of justice between man and man, so we may say, that the whole end of Political Economy is to regulate the currency.

3. We shall, then, shortly state the principles which the Bank of England has stated to have guided it, in various monetary crises, their results, and the principles upon which the Bank Act of 1844 is intended to be founded; by which we mean the specific theory of currency adopted by its framers, and also examine whether it does carry out those principles, and also how the Bank has managed itself in the crises which have occurred since its passing.

4. The first crisis of which we have a distinct account took place in 1782, when the unhappy war with America was fortunately terminated, and immediately a prodigious extension of the foreign commerce, which had been previously unusually restricted, took place. The enormous

markets thrown open to the merchants, led to the most extravagant overtrading, which was greatly fostered by the most incautious issues by the Bank,* and a very alarming drain of specie from the Bank, which produced a crisis threatening to compel them to stop payment. The directors, however, considered that if they could only restrain their issues for a short period, the returns in specie in payment of the exports would soon set in in a more rapid manner than they went out. They determined, therefore, to make no communication to the government, but for the present to contract their issues, until the exchanges turned in their favour. The alarm felt by the Bank was greatest in the month of May, 1783. They then refused to make any advances to government on the loan of that year, but they did not make any demand for payment of the other advances to government, which were then between nine and ten millions. They continued this policy up to October, when at length the drain had ceased from the country, and money began to flow in from abroad. At length, in the autumn, when the favourable signs began to appear, they advanced freely to government on the loan, although at that time, the cash in the Bank was actually lower than at the time when they felt the greatest apprehensions.†

5. The doctrine then stated by Mr. Bosanquet that guided the directors was this: That while a drain of specie is going on, their issues should be contracted as much as possible, but that as soon as the tide had given signs of ceasing and turning the other way, it was then safe to extend their issues freely. This was the policy they acted upon, and it was entirely successful, and the credit of the Bank was saved.

*Evidence of Mr. Tooke—Committee on Bank of England Charter, 1832, p. 269.

† The evidence of Mr. Bosanquet before the Lords' Committee of Secrecy, 1797, p. 31; and before Commons' Committee, p. 26. It was reduced to £473,000. Evidence of Mr. Tooke before Committee on Bank of England Charter, 1832.

6. At this period, as is well known, an immense extension took place in the industry of the nation. From being one of the most backward of European nations in this respect, it suddenly became one of the most active. Burke says, that when he first came to England in 1750, there were not 12 bankers out of London.* These prodigious industrial works that then commenced, demanded a very much enlarged currency to carry them on. The Bank of England would not establish any branches in the provinces, and its monopoly prevented any other banks of large and solid capital being formed. The consequence was that multitudes of small shopkeepers of all sorts started as "bankers," *i. e.*, issuers of paper currency, in all directions. By 1793, there were nearly 400 country bankers inundating the country with their notes. There was at this period, and had been for some time previously, an enormous and undue extension of commercial speculation all over Europe and America. In the autumn of 1792 general failures began, and became very serious in January, 1793, and in February, when war was declared, a general crash came. Three hundred country banks were very much shaken, and upwards of 100 stopped payment.

7. This great pressure extended to the London bankers as well as the country ones. One of them says that the extraordinary state of credit had obliged every person connected with trade and money transactions, to gather in and husband every resource to meet all demands. That for six weeks back every man of money and resources had been straining every nerve to support himself and immediate friends, and could not give that support to others which they would have been disposed to do. All these circumstances naturally produced a demand on the Bank of England for support and discounts. But the Bank being thoroughly alarmed, resolved to contract its issues. Bankruptcies multiplied with frightful

* Letters on a Regicide Peace. Works Vol. II. p. 292.

rapidity. The government urged the Bank to come forward and support credit, but they resolutely declined.

8. Sir Francis Baring* greatly blames the directors for their conduct on this occasion. He says that they at first accommodated themselves to the crisis, but their nerves could not support the daily demand for guineas, and for the purpose of checking that demand, they curtailed their discounts to a point never before experienced; and that if they determined to reduce their issues, it should have been gradual. Their determination, and the extent to which it was carried, came like an electric shock.

9. He says that there are three different causes for a great demand for guineas.†

1. For Export.

2. For the purpose of hoarding, from want of confidence in the government, and in the circulating paper.

3. To enable country banks to discharge their demands, whilst confidence in the government and in the bank remained entire.

That every measure ought to be taken to prevent and mitigate the first cause, except prohibition or bankruptcy. We may reserve the second till we come to 1797. That the third ought to be viewed, not with indifference, but with a disposition to spend almost their last guinea. He shews, from the state of the exchanges, that it was quite impossible the guineas could have left the country, as the loss on exporting them to Amsterdam was £3 6s. 3d., and to Hamburg, £4 2s. 6d. per cent., and it was notorious that large quantities of gold and silver were coming in from France. The cause of this was the continued depreciation of the assignats. Under these circumstances, he says that the directors acted quite wrongly, they ought to have seen that the guineas would have very soon come back to them, and that they ought, in fact, to have followed the precedent of 1783, which had been so successful.

* Observations, &c. p. 21. † Ibid. p. 23.

10. When the Bank adopted this perverse course, universal failure seemed imminent. Sir John Sinclair remembered the precedent of 1697, when Montague had sustained public credit by an issue of Exchequer bills, and thought that a similar plan might be followed in this crisis. The minister desired him to propose a scheme for the purpose, which he presented on the 16th April.* A committee of the House of Commons was immediately appointed. In the meantime, a director of the Royal Bank of Scotland came up with the most alarming news from Scotland. The public banks were wholly unable, with due regard to their own safety, to furnish the accommodation necessary to support commercial houses, and the country bankers. That unless they received immediate assistance from government, general failure would ensue. Numerous houses, who were perfectly solvent, must fall, unless they could obtain temporary relief. Mr. Macdowall, M.P. for Glasgow, stated that the commercial houses and manufactories there were in the greatest distress from the total destruction of credit. That this distress arose from the refusal of the Glasgow, Paisley, and Greenock banks to discount, as their notes were poured in upon them for gold.

11. The committee reported† that the general embarrassment of commercial credit was so notorious as to call for an immediate remedy, without much examination. That the failures which had taken place, had begun with a run on those houses that issued circulating paper without sufficient capital, but had extended so as to affect many houses of great solidity, and possessed of funds ultimately much more than sufficient to answer all demands upon them, but which could not convert those funds into money in time to meet the pressure. That the sudden discredit of so large an amount of bankers' notes

* Sinclair's Hist. of the Public Revenue, Vol. II. p. 289.

† Parl. Hist. Vol. XXX. p. 740.

had produced a most inconvenient deficiency of the circulating medium. These circumstances had caused bankers to hoard to a great extent. That unless a circulating medium was provided, a general stoppage must take place. That they had requested a number of the most eminent merchants to meet and consider a plan of issuing Exchequer bills to a certain amount, under proper regulations, who had unanimously agreed in the propriety of such a course, as the best remedy that could be devised.

12. The committee recommended that Exchequer bills to the amount of £5,000,000 should be issued under the directions of a board of commissioners appointed for that purpose, in sums of £100, £50, and £20, and under proper regulation.* After considerable doubts were expressed by Mr. Fox and Mr. Grey, as to the policy of this extraordinary measure, which was unknown to the constitution and might subvert our liberties, the bill passed.

13. No sooner was the Act passed than the committee set to work. A large sum of money, £70,000, was sent down to Manchester and Glasgow on the strength of the Exchequer bills, which were not yet issued. This unexpected supply coming so much earlier than was expected, operated like magic, and had a greater effect in restoring credit than ten times the sum could have had at a later period.†

14. When the whole business was concluded, a report was presented to the Treasury.‡ It stated the knowledge that the loans might be had, operated, in many instances, to prevent them being required. The whole number of applications was 338, and the sum applied for £3,855,624, of which 238 were granted, amounting to £2,202,000; 45 for sums to the amount of £1,215,100 were withdrawn, and 49 rejected. The whole sum ad-

* Sinclair—Hist. of Revenue, Vol. II. p. 298.

† Ibid. p. 754.

‡ Parl. Hist. Vol. XXX. p. 754.

vanced was repaid; two only of the parties assisted became bankrupt, all the others were ultimately solvent, and in many instances possessed of great property. A considerable part of the sum was repaid before it was due, and all the rest with the utmost punctuality. So much scrupulous care was taken to preserve secrecy as to the names of the applicants, that they were not known to that hour except to the commissioners and their own sureties. After all expenses were paid, the transaction left a clear profit to the government of £4,348.

15. Whatever were the prognostications of its futility and danger before it was done, its success was perfect and complete. The contemporary writers all bear witness to the extraordinary effects produced. Macpherson says, that the very intimation of the intention of the legislature to support the merchants, operated like a charm all over the country, and in a great degree superseded the necessity of the relief, by an almost instantaneous restoration of confidence.* Sir Francis Baring concurs in this view, and adduces the remarkable success of the measure as an argument to shew the mistaken policy of the bank. The panic was at length happily staid. The failures up to July had been 932, in the remaining five months they were reduced to 372. The gold continued to flow in, and in the last six months of 1793, and during the two following years, money became as plentiful as in time of peace,† and 4 per cent. interest could scarcely be got.

16. All contemporary writers bear witness to the wonderful success of this expedient. After careful deliberation the Bullion Report warmly approved of it, censured the proceedings of the Bank of England, and especially cite it as an illustration of a principle which they laid down, that an enlarged accommodation is the true remedy for that occasional failure of confidence

* Annals of Commerce. Vol. iv., p. 269.

† Sir F. Baring—Observations, &c., p. 46.

in the country districts to which our system of paper credit is unavoidably exposed.

17. In the same year Mr. Pitt had obtained an Act of Parliament, removing all restrictions on the powers of the bank advancing to government,* and he proceeded to draw on them to an unparalleled extent. At the same time enormous subsidies were sent abroad. These proceedings began to alarm the directors in December, 1794, and throughout 1795, they made repeated, though unavailing efforts, to curb Mr. Pitt. These perpetually increasing issues of paper turned the exchanges against the country in May 1795, nevertheless, they continued to be increased. In the autumn the drain became still more serious; the market price of gold rose to £4 4s. the ounce. In December, 1795, they found that they must take the most stringent measures to save themselves, and resolved to fix beforehand the amount of advance they could make day by day, and gave notice that if the application on any day exceeded the sum so resolved to be advanced, a *pro ratâ* proportion of each applicant's bills should be returned without regard to the solidity of the bills.

18. During the first three months of 1796, the immense foreign loans, and the extravagant issues of the Bank, kept the foreign exchanges adverse. But after that, the severe restrictive measures it adopted turned the exchanges in favor of the country, and gold began to flow in in the autumn. However, the Bank did not relax its stringency to the merchants, but Mr. Pitt was constantly drawing upon them. At the end of 1796, and beginning of 1797, a severe drain set in upon the Bank for internal purposes, the country banks foreseeing that the storm would burst upon them first, as it had done in 1793.

19. Although there was no danger of a discredit of the note, and the drain was merely to serve internal purposes,

* Theory and Practice of Banking. Vol. II., p. 78.

the directors increased the stringency of their measures. The exchanges were decidedly favourable, but the Bank pursued such a severe policy, that in five weeks its issues were contracted by nearly £2,000,000. On the 21st January, they stood at £10,550,000; and on the 25th February, they were reduced to £8,640,250. The private bankers, of course, were obliged to follow a similar course. On the 25th the pressure upon the Bank was so severe, that an order in council was sent to them to suspend payment on Monday the 27th. It had then £1,086,170 in cash.

20. The relief produced by this measure was immense. It immediately enlarged its discounts. Within one week it increased its accommodation by nearly two millions.

22. In the enquiry that ensued the most competent witnesses entirely condemned the policy of the Bank, and attributed the immense depreciation from the forced sales of stock, to the excessive rigor of the contraction.* In the year 1810 the governor of the Bank being examined before the bullion committee, stated that, after the experience of their policy of restriction, many of the directors repented of the measure; and the bullion committee explicitly condemned the policy of the Bank, both in 1793 and 1797. And this opinion seems perfectly correct. Nothing could be more unhappy than their regulations of the amount of their issues. When the exchanges were violently adverse, so that it was enormously profitable to export gold, they enlarged them to an extravagant extent; and when the exchanges were extremely favorable, so that gold was sure to flow in, they restricted them with merciless severity. The issues, which were £14,000,000 when the exchange was against the country, were reduced to £8,640,000 when they had been for several months eminently favorable. We thus see how totally the directors had forgotten the principles which were so successful in 1783.

* Theory and Practice of Banking. Vol. II. p. 96.

22. The long continuance of the bank restriction, and the substitution of the paper promises of the Bank of England for solid bullion, had completely debauched the minds of the far larger portion of the commercial world, and the majority of parliament. They wholly lost sight of the true principles of the currency, and ostentatiously maintained the opinion that the pound was an absolute nothing, and might be as well represented by a bit of paper, as well as by bullion. They came to the solemn resolution, that a Bank of England pound note and 1s., which would only exchange for 15s., was the same thing as a golden guinea which would exchange for 21s. With the examples of the French assignats before them, they strenuously maintained that the issues of notes could have no effect upon the exchanges. These ideas were not very long in again being put to the test, after the Bank had, substantially speaking, resumed cash payments in 1817.

23. In October, 1817, the Bank had very nearly £12,000,000 of bullion, and it gave notice that it was prepared to pay off all its notes dated before the 1st January of that year. At that time very large loans for foreign countries were being contracted for, which were trying to replace their depreciated paper currency by a metallic one, and as money was abundant in England, a large portion was taken up here. In consequence of these the exchanges began to give way, and the market price of gold to rise. These phenomena increased gradually throughout 1818, until in January, 1819, the paper or market price of gold was £4 3s., the exchange on Hamburg 33·8, and that on Paris 23·50. In July, 1817, the new gold coinage began to be issued in large quantities. The consequence was that a demand for gold set in upon the Bank, and in pursuance of its notices, £6,756,000 was drawn out of it in gold, and this continued during 1818. The Bank directors, however, determined to set all the principles of the Bullion Report ostentatiously at defiance. While this great drain was going on, they increased their advances to government from £20,000,000 to £28,000,000,

and though they knew perfectly well that the demand for gold was for exportation, they took no means to check it, by diminishing their issues. At the same time the issues of the country banks had increased by two-thirds since 1816.

24. It soon became evident that the Bank would be entirely drained if a suspension of cash payments were not resorted to. On the 7th of April an Act was passed to prohibit the Bank from making any payments in cash in terms of its notice. Committees of both houses were then appointed, with Mr. Peel as chairman of that of the Commons.

25. The chief points of interest in these reports regarding our present subject are the opinions held by the witnesses respecting the great doctrines of the bullion report. The report of neither House entered into the question of the theory of the currency. They were confined to recommending a certain course of action, but they examined a number of witnesses of the first eminence on the subject, and the result of their evidence is most extraordinary. It will be remembered that both in 1804 and 1810, the immense preponderance of commercial testimony was entirely adverse to the doctrine that the issues of paper currency had any effect upon the exchanges or the price of bullion, or should be regulated by them. Nevertheless, the reports of both committees were entirely in the teeth of the mercantile evidence. The Bullion Report had now been before the country for nine years, and had caused more public discussion, both in parliament and in the press, than almost any subject whatever; and it is perfectly manifest that if its principles were erroneous, the commercial world would only have been further strengthened in their opposition to them. But what was the result now? The overwhelming mass of commercial evidence was entirely in their favour. The current of mercantile opinion was now just as strong on their side as it had formerly been against them. What could be more triumphant than this? What could be more

splendid testimony to their accuracy and soundness than the fact that they had converted the immense hostile majority of the commercial world?

26. The resolutions in the Commons were introduced by Mr. Peel, on the 24th May,* who freely owned that in consequence of the evidence he had heard and the discussions upon it, his opinions had undergone a material change. He acknowledged without shame or remorse, that his opinions were very different now to what they were when he voted against Mr. Horner's resolution in 1811. Having determined to dismiss from his mind all former impressions, and the memory of the vote he had formerly given, and to give the question his unprejudiced and undivided attention, he had now come to the conclusion that Mr. Horner's resolutions represented the true nature and laws of our monetary system. Every sound writer agreed that the true standard of value consisted of a definite quantity of gold bullion, a certain weight of which with an impression on it, denoting it to be of that certain weight and fineness, constituted the only true intelligible and adequate standard of value. No doubt the Bank was perfectly solvent, but did it follow from that, that there could be no over-issue of its paper? If solvency alone was a sufficient proof that there was no excess of circulation, the theory of Mr. Law was just, and the land as well as the funds might be safely converted into a circulating medium. There was, in fact, no test of excess or deficiency but a comparison with the price of gold. As the Bank had so entirely repudiated the principles of the Bullion Report, they could not be expected to act upon them; it might therefore appear necessary to prescribe such a limitation of their issues as would secure the power of the Bank over the foreign exchanges. He himself thought this a very unwise plan, because it depended so much on circumstances, whether or not there was an excess of circulation. *There were occasions when what was called a run on the Bank might be arrested in its injurious consequences by an increase of its*

* Par. Debs. Vol. XI. p. 676.

issues. There were other occasions when such a state of things demanded a curtailment. In the year 1797, when a run was made on the Bank, but when the exchanges were favorable, and the price of gold had not risen, it was proved that an extension of issues might, by restoring confidence, have rendered the original restrictions unnecessary. On the other hand, if the run was the effect of unfavourable exchanges and the consequent rise in the price of gold, the alarm must be met by a reduction of the issues. *It was, therefore, impossible to prescribe any specific limitation of issues* to be brought into operation at any period however remote. The quantity of circulation which was demanded in a time of confidence varied so materially from the amount which a period of despondency required, *that it was an absolute impossibility to fix any circumscribed amount.* He said that the time was come when the connection that existed between the government and the Bank must be dissolved, and it must revert to its original principle of business. The obstinate opinions of the directors of the Bank shewed that they were unfit to be trusted with the management of the pecuniary interests of the British community. The House must resume its powers which it had abdicated too long. There could be no inconvenience in compelling the Bank to pay in specie at the mint price. They had done so from 1776 to 1797, and the price of gold never rose above £3 17s. 6d. But it was said that it had since risen to £5 2s. and that the standard was variable. The fact was, we had since then introduced a substitute for gold, and its price was considered in relation to that substitute. Let not the House be led away by any calculation to mistake the PRICE for the VALUE. When people talked of gold rising in *price*, were they prepared it show that it had risen in *intrinsic value*? Let them not talk of its price in paper, but in any other commodity of a real and fixed value. So far from gold having risen in value, since the last fifty years, it had actually fallen in value, partly from the greater

abundance of the metal itself, and partly from the substitutes that were used for it. A very prevalent theory was, that instead of regulating paper by the value of gold—gold should be regulated by the value of paper. This was nothing less than a fraud upon the public creditor. It was vain to think that foreign nations could be imposed upon by such a deception. The only result would be that after the public creditor had been cheated, the coin would be debased. The only course was to revert to the ancient standard of the realm, and to beware of arguments which were not only fraudulent, but would not accomplish their own objects, while they would aggravate present difficulties. Every deviation from the ancient practice would be quoted as a precedent for a more extended departure from that practice. Under future difficulties the conduct of their ancestors would be panegyrised by the advocates of the suspension of cash payments, and conclude because the price of gold had risen still further in its relation to paper, that the principle by analogy ought to be extended. The restoration of the value of our currency had always been a striking political feature in the history of the country, and an object of the most earnest solicitude of our most distinguished statesmen. Three periods were especially memorable for great reforms in the coinage—in the reigns of Edward I., Queen Elizabeth, and William III. These periods must ever be regarded with pride and satisfaction. They were of much greater difficulty than the present. On Queen Elizabeth's accession, the coin was reduced to $\frac{1}{4}$ of its nominal value. Under Burleigh's advice she resolved to restore the value. Plenty of persons dissuaded her from that idea, alleging the difficulties of the attempt. But Burleigh maintained that those very difficulties should constitute the motives for perseverance, as they must raise and establish the character of the country, and inspire its enemies with respect. The Queen had nobly persevered, and in her monumental inscription, above all her titles to distinction, this one shone preeminent,

"**MONETA IN JUSTUM VALOREM REDUCTA.**" He then detailed the restoration of the coinage by William III. The arguments against it in those times were identical with those used against it at the present time. However, fortunately, the firmness of King William and Mr. Montague triumphed over prejudices in theory, misconception in reasoning, and the greatest financial and political difficulties. The idea that this country owed its glory and military honours to an inconvertible paper currency was ridiculous; we had abundance of prosperity and military glory before 1797, before we were blessed with an inconvertible paper currency. The true reason of her difference from other states was that she had always kept her faith inviolate. It was this that cheered the country under all dangers, and caused her to exult in victory. It was this feeling that carried the country through the dismal voyage she had just accomplished, and now that they had reached the other shore in safety, let them not abandon the great principle which had supported them. Every consideration of policy, good faith, and justice, called upon them to restore the ancient and permanent standard of value. He allowed that he had once entertained views different from those he now held, but he had given his mind candidly to a re-investigation of the whole subject, and he felt himself bound to state honestly, that he was now a convert to the doctrines regarding our currency he had once opposed.

27. We must beg the especial attention of our readers to the preceding abstract of Sir Robert Peel's speech on this occasion. It will be seen that he was now in the **SECOND** state of his opinions on the currency question, and we shall see whether they correspond with his ultimate state when he carried his Bank Act of 1844. The Bank ultimately resumed payment, on the 1st May, 1821.

28. The overwhelming preponderance of mercantile opinion in 1819, adhered to the doctrines of the Bullion Report. One body alone obstinately refused to be

convinced—the majority of the Court of Directors of the Bank of England. Notwithstanding that the governor and deputy-governor, and several other directors of the Bank, had given in their adherence to these doctrines, the majority of the court still persisted in the old opinions, and on the occasion of some questions having been sent for their consideration by the committee of the House of Commons, took the opportunity of recording publicly their disapproval of the doctrines which were now in the ascendant. On the 25th March they resolved—

“That this court cannot refrain from adverting to an opinion, strongly insisted upon by some, that the Bank has only to reduce its issues, to obtain a favourable turn in the exchanges, and a consequent influx of the precious metals; the court conceives it to be its duty to declare that it is unable to discover any solid foundation for such a sentiment.”*

It took eight years longer for the light to penetrate the Bank parlor. At length in 1827, the Bank was at last obliged to strike its colors, and the resolution was solemnly expunged from their books.

29. The next great occasion on which the truth of the principles of the Bullion Report was manifested, was in the great crisis of 1825. From various circumstances which we have fully detailed elsewhere,† capital had accumulated so rapidly in 1823, that interest was driven down to an unusually low rate. The Scotch Banks gave no interest on deposits. This generated an enormous speculative fever. A great drain of bullion began early in 1824. Between January and October, the bullion sank from fourteen to eleven millions. The exchange on Paris had been falling ever since the close of 1823. The last time it was above par was in June 1824, and since then the fall was continuous. The decrease in bullion had been steady, uniform, and rapid, ever since March. Now, when it was known that immense sums were leaving the

* Commons' Report, p. 263.

† Theory and Practice of Banking. Vol. II. p. 241. *et seq.*

country, and the exchange falling, what was the policy of the Bank? It *increased* its issues. During the month of October 1824, they were increased £2,300,000. In April 1825, their issues were $3\frac{1}{2}$ millions higher when they had only $6\frac{1}{2}$ millions, than when they had 14 millions.

30. In the middle of 1825, the coming storm began to portend. The Bank at last awoke to its folly in May. The country bankers had followed in the speculative steps of the Bank, and foreseeing the danger began to provide for it. The Bank then began violently to contract its issues. This sudden change of policy only aggravated the general feeling of discredit. As the autumn went on the surrounding gloom became deeper and deeper; at last the storm fairly began on the 29th November, by the fall of several large country banks. On the 3rd December, the panic began in London. On the 12th December, one of the greatest city bankers stopped. A general run took place, and several more came down, dragging with them a multitude of country connections. That was the great week of the panic.

31. The papers and the public had fully anticipated that the Bank would maintain a policy of the most rigid severity, and let the evil work its own cure, by the fall of the houses who had been imprudent in their speculations. And the Bank fully acted upon this policy up to Wednesday, the 14th December. The ministers decidedly refused to sanction a restriction Act, and the Bank resolved to pay away its last sovereign. The mint was kept constantly at work, but it could not supply coin with sufficient rapidity, and it kept constantly diminishing. But this policy would not do. And on the 14th the Bank totally changed its policy, and discounted with the utmost profuseness. They made enormous advances upon Exchequer Bills, and securities of all sorts. Mr. Harman said, "We lent it by every possible means, and in modes we had never adopted before; we took in stock as security, we purchased exchequer bills, we made

advances on exchequer bills, we not only discounted outright, but we made advances on deposits of bills of exchange to an immense amount, in short, by every possible means consistent with the safety of the Bank, and we were not on some occasions over nice; seeing the dreadful state in which the public were, we rendered every assistance in our power." Between Wednesday and Saturday, the Bank issued £5,000,000 of notes, and this audacious policy was crowned with the most complete success; the panic was almost instantly stayed! By Saturday, the 17th, the panic in London was stayed, and during the following week by despatching a large supply of Bank £1 notes, which were opportunely found, to the country districts, the panic was allayed there.

32. The circumstances of this famous crisis are the most complete and triumphant examples of the truth of the principles of the Bullion Report, and of Sir Francis Baring, already quoted. When the drain of treasure from the Bank was severe and unceasing, and notoriously for exportation on account of foreign loans, the Bank, with infatuated obstinacy, had increased their issues, instead of contracting them, in defiance of the clearest warnings of the Bullion Report. When after six months continuance in this fatal policy they at last reversed their course, and contracted their issues. In the course of the autumn, the drain for exportation ceased, but continued for internal purposes, the demand for gold was entirely to support the tottering credit of the country bank notes. Now, as the country bankers were only too glad to withdraw their own notes, and substitute gold for them, there was not the slightest danger of an increase of Bank of England notes adding to the general amount of the currency of the country, but just the reverse. Consequently, it was just the precise case in which Sir Francis Baring and the Bullion Committee said that it was the duty of the Bank of England to *extend* its issues to support general credit. There was not the smallest danger that an extension of issues would, under such circumstances, turn the foreign

exchanges against the country. The character of the demand was declared in the most unmistakable manner. On Thursday the 15th, a meeting of merchants took place, when it was shewn that Pole and Co. had a surplus of £170,000, after the payment of all claims upon them, besides large landed and other property of the partners. Another great house had enough to pay 40s. in the pound. Now, if the course that had been adopted on the Wednesday had been adopted on the Monday, these tremendous catastrophes might have been avoided. One of the principal country bankers wrote to them to point this out to them.

He said :

“ My opinion was, that the crisis at that time was brought on by excessive issues ; but when the panic came, country bank paper was brought in for Bank of England, and, therefore, all that was immediately wanted was an EXCHANGE OF PAPER. I stated in a letter I wrote upon the subject to the Bank, on the 14th December, 1825, that they would not have to increase the sum total of circulation, but all they would have to do was to exchange A. for B., and in my letter I recommended them to issue a million a day, which they did, for otherwise most of the Banks in London, as well as the country, must have stopped.”

And accordingly they did issue, and all contemporary evidence proves that it was this profuse issue of £5,000,000 of paper in a few days, that stayed the panic. If they had persevered in the restrictive policy for three days longer the total and entire destruction of commercial credit would infallibly have ensued. In short, if they had followed the precedents of 1793 and 1797, so strongly condemned by the Bullion Report, all credit would have been destroyed. They followed the principles laid down in the Bullion Report, and the country was saved.

33. Sir Robert Peel at this time was as we have seen, an entire convert to the principles of the Bullion Report, and the next occasion when we have him delivering his opinion on the subject, was at the renewal of the Bank Charter in 1833, when Bank notes were first

declared to be legal tender, except by the Bank itself. He said "that it was expedient for the public interest that there should be but one Bank of Issue in the metropolis, in order that it might be enabled to exercise an undivided control over the issue of paper, and *give facilities to commerce in times of difficulty and alarm*, which it could not give with the same effect, if it were subject to the rivalry of another establishment."* He resisted at great length, the proposition of making Bank Notes legal tender, as a departure from the principle of the Act of 1819, and the true principles of a paper currency. He also strongly doubted the policy of giving the Bank of England a monopoly of the paper currency.

34. A most important change about this time began to take place in the opinions of many mercantile men as to the meaning of the word "currency" or "circulating medium." We have seen that the immense preponderance of opinion before this included Bills of Exchange under the title of circulating medium. At this period the majority of commercial witnesses excluded them from that name, which they exclusively confined to money and Bank notes payable to bearer on demand. We have in a previous chapter examined and refuted this opinion. But at this time a more extraordinary dogma still became prominent, which was this; "*That when Bank notes are permitted to be issued the number in circulation should always be exactly equal to the coin which would be in circulation if they did not exist.*" This principle is contained in the evidence of Mr. Loyd, which we have already quoted at p. 333. And this principle, its advocates have denominated the "CURRENCY PRINCIPLE." Now, as Lord Overstone gave no reason for this principle, but announces it dogmatically, we shall call it Lord Overstone's dogma, because he is the most distinguished advocate of it.

35. It is well known that one of the points which

* Hansard. Third Series. Vol. xviii. p. 1336.

Bacon most strenuously insists upon, is extreme caution in arriving at the highest general principles, of flying too soon at the highest generalizations. This dogma of Lord Overstone's is a specimen of the worst species of this error. He gives no reason whatever for such an opinion, it is a mere naked dogma, resting on no foundation whatever, and it is one of the greatest delusions ever palmed off on the credulity of mankind, and never could have emanated from or been believed in by any one who had the slightest knowledge of Banking accounts.

36. At the hazard of some repetition, but for the sake of clearness, we will bring the various points of the question together before the reader:—

All theories of paper currency, however numerous and perplexed they may appear to be, may be reduced to three varieties:

1. To issue paper based upon bullion.
2. To issue paper based upon land, the public funds, or upon commodities.
3. To issue an inconvertible paper currency.

Of these, the second is John Law's theory, which we have elaborately refuted; the third is confined to a very small knot of persons, and is not worth arguing about. We may confine our attention to the first alone, which makes bullion the only proper basis of a paper currency.

37. But the advocates of this theory are divided into two sects. The one maintains that if bank notes are permitted to be issued, they ought to be *exactly equal in quantity to the coin they displace*. This is what we have said is called in modern times the "currency principle." The other party maintains that this limitation is unnecessary, and that it is too severe. They say that if the notes are made payable on demand, and are, practically speaking, convertible at the will of the holder, that the extent of these issues may safely very greatly exceed the amount of specie that would be in circulation under a purely metallic currency. They say that the true test of

the proper quantity of paper that may be safely issued is to be found in the market price of gold bullion, and the state of the foreign exchanges.

38. Of these two principles the first is that which was adopted when a paper currency was first invented. And of this the Bank of Venice was the first example; which we may take as the type of them. This bank, as we have seen at page 279, merely exchanged its notes for bullion, which it kept in its vaults until demanded again in exchange for notes. Consequently, the notes in circulation were always exactly equal to the bullion they were substituted for. The bank never did any business on its own account, it was a mere office for exchanging notes for bullion, and bullion for notes. This, then, was the currency principle pure and simple.

39. As a type of the banks constructed on the second principle, we may instance the Bank of Scotland. It was organized as follows: A number of adventurers paid in a certain quantity of cash to a common fund, and they were allowed to issue as many notes as they pleased upon this basis, on the simple condition that they should always be payable to bearer on demand. This bank did business upon its own account. It discounted bills of exchange with its own notes. For ten years after its foundation it received no deposits from the public. It was, in fact, endowed with the power of creating money by issuing its own notes, which were equivalent in fact to an anticipation of deposits from the public. Within a few years of its foundation its notes in circulation were five times the amount of specie it held, which were equivalent to so much additional money to the nation. We see, therefore, that these two banks were constructed on very different principles, and that the credit of a paper currency could be supported on a metallic basis of one fifth.

40. The Bank of England was constructed on a principle different to either of these. It was, in fact, intermediate between them. For while it was not rigidly restrained to exchanging paper for bullion like that of Venice, it was

not allowed to issue paper *ad libitum* like that of Scotland. Its whole capital, £1,200,000, was lent to government, and it was allowed *to issue notes to the same extent*, the credit of which was supported by the annuity payable by government for the loan of its capital. Now, it is quite manifest that as the original £1,200,000 raised in specie from the contributors to the Bank was lent to government, and was spent in carrying on the war, and the Bank was permitted to manufacture and issue notes to an equal extent, for the purposes of commerce, that the nation had the benefit of the money *TWICE* over, and that the amount of notes issued were exactly that quantity in *excess* of the existing metallic currency. The Bank also made a double profit, because it had the 8 per cent. paid by the government on the original loan, and *ALSO* the commercial profits on the use of the notes. Hence, we see that to the extent of £1,200,000 the Bank was founded on a violation of the currency principle.

41. Some other additions were made to the capital of the Bank on a similar principle, until at last all restrictions were taken away, and it was allowed to make unlimited issues on their being payable to bearer on demand. But a large number of London bankers were at the same time making unlimited issue of their own promissory notes, so that we see at this period the "currency principle" was not even thought of. And until the Bank Restriction Act of 1797, this paper was always convertible at will.

42. We have already detailed the establishment of the principle, that during the restriction, and the inconvertibility of the note, that the depreciation of the note was to be estimated by the market price of gold bullion and the foreign exchanges. And all the advocates of this principle declared that that was the sole test of an excessive quantity of paper. In the year 1810, the Bullion Committee adopted this principle. All the speakers in Parliament who adopted the bullionist side of the question maintained the same views. They all maintained that the more paper there was, the better, so long as it was

payable to bearer on demand, and the state of the foreign exchanges carefully watched. No countenance or favor was shewn by any one to the doctrine of the currency principle; not that it was unknown, it was perfectly well known and condemned. Mr. Thornton, one of the most eminent of the party who was one of the framers of the bullion report, says of it in his *Inquiry into the Nature and Effects of Paper Credit*, "Some political persons have assumed it to be a principle that in proportion as the gold of the Bank lessens, its paper, or as is sometimes said, its loans. (for the amount of the one has been confounded with that of the other) ought to be reduced. IT HAS BEEN ALREADY SHEWN THAT A MAXIM OF THIS SORT, IF STRICTLY FOLLOWED, WOULD LEAD TO UNIVERSAL FAILURE." Here we have a direct and explicit condemnation of the currency principle, by a writer who was thoroughly familiar with the practical part of the question, and was acknowledged to be one of the most eminent authorities of his day.

43. The principles of the Bullion Report were adopted by Parliament and Sir Robert Peel, in 1819, and all the speakers, Sir Robert Peel included, maintained that it was impossible to limit the issues of the Bank, and adopted the test of the market price of bullion and the foreign exchanges as the only guide on the subject, as we have fully shewn before. And this was the *second* state of Sir Robert Peel's opinions on the Currency question, and all this time there was not a syllable breathed in favor of the currency principle. On the contrary, it was expressly repudiated. This we must beg our readers carefully to bear in mind, that in 1819 THE CURRENCY PRINCIPLE WAS TOTALLY REPUDIATED BY THE AUTHORS OF THE ACT OF 1819.

44. Time, however, wore on. The Bank rejected the principles of the Bullion Report, both in theory and practice, and brought on the crisis of 1825. We have seen that they attempted measures of the most extreme severity in the panic, and were obliged to abandon them,

and saved themselves and the country by so doing. In 1833, Sir Robert Peel again gave it as his opinion that it was imprudent to encourage the formation of another Bank in the metropolis, because it would not so well be able to give facilities to commerce in times of difficulty; *another distinct repudiation of the Currency principle.* And up to this time there was no advocate of the currency principle.

45. The Bank in 1838 was greatly mismanaged, and brought on the crisis of 1839, and it was at this time that the Currency principle, which had been so long rejected, came into fashion under the leadership of Mr. Jones Loyd, now Lord Overstone, and several other writers of note. These opinions being advocated by men of great ability, converted Sir Robert Peel, who now entered upon the THIRD state of his opinions upon the currency question.

“ Sic volvenda ætas commutat tempora rerum,
Quod fuit in pretio, fit nullo denique honore,
Porro aliud succedit, et e contemptibus exit,
Inque dies magis appetitur, floretque repertum
Laudibus, et miro st mortaleis inter honore.”

46. The Bank Act of 1844 is a formal and deliberate attempt to carry into effect the currency principle. On the 6th May, 1844, Sir Robert Peel moved a resolution of the House, that it was expedient to continue for a limited time certain of the privileges then enjoyed by the Bank of England, subject to any conditions that might be passed by any act for that purpose.* In bringing this resolution forward, he gave a preliminary sketch of the evils of the paper currency as it then stood, and the methods he proposed for placing it on a sounder footing. After dwelling on the importance of a metallic standard, and exposing the absurdity of the theories which were so prevalent during the Restriction Act, and the advantage of having a single standard of value, he addressed himself

* Hansard. Third Series, Vol. LXXIV. p. 720.

to the more immediate subject for consideration—the state of the paper circulation of the country, and the principles which ought to regulate it.—

“ I must state at the outset, that in using the word money, I mean to designate by that word the coin of the realm, and promissory notes payable to bearer on demand. In using the words paper currency, I mean only such promissory notes. I do not include in these terms bills of exchange, or drafts on bankers, or other forms of paper credit. There is a natural distinction, in my opinion, between the character of a promissory note payable to bearer on demand and other forms of paper credit, and between the effects which they respectively produce upon the prices of commodities, and upon the exchanges. The one answers all the purposes of money, passes from hand to hand without endorsement, without examination, if there be no suspicion of forgery; and it is in fact what its designation implies it to be, currency or circulating medium. * * * I think experience shews that the paper currency, that is, the promissory notes payable to bearer on demand, stands in a certain relation to the gold coin and the foreign exchange, in which other forms of paper credit do not stand. There are striking examples of this adduced in the Report of the Bullion Committee of 1810, in the case both of the Bank of England, and of the Irish and Scotch banks. In the case of the Bank of England shortly after its establishment, there was a material depreciation of paper in consequence of its excessive issue. The notes of the Bank of England were at a discount of 17 per cent. After trying various expedients, it was at length determined to reduce the amount of Bank notes outstanding. The consequence was, an immediate increase in the value of those which remained in circulation, the restoration of them to par, and a corresponding improvement in the foreign exchanges. In the case of Ireland in 1804, the exchange with England was extremely unfavourable. A committee was appointed to consider the causes. It was denied by most of the witnesses from Ireland that they were at all connected with excessive issues of Irish notes. * * * In the spring of 1804 the exchange of Ireland with England was so unfavourable that it required £118 10s. of the notes of the Bank of Ireland to purchase £100 of the notes of the Bank of England. Between the year 1804 and 1806, the notes of the Bank of Ireland were reduced from £3,000,000 to £2,410,000, and the effect of this, taken in conjunction with an increase of the English circulation, was to restore the relative value of Irish paper and the exchange with England to par. In the same manner an unfavourable state of the exchange between England and Scotland has been more than

once corrected by a contraction of the paper circulation of Scotland. In all these cases the action has been on that part of the paper credit of the country which has consisted of promissory notes payable to bearer on demand. There has been no interference with other forms of paper credit, nor was it contended then, as it is now contended by some, that promissory notes are identical in their nature with bills of exchange, and with checks on bankers, and with deposits, and that they cannot be dealt with on any separate principle."

47. Now, every one of Sir Robert Peel's statements in this speech are utterly erroneous! In the first place, he was now infected with the heresy that Bills of Exchange are not currency, or circulating medium. The entire fallacy of the examples he quoted, we have amply demonstrated elsewhere,* and the assertion, that at those periods promissory notes were not held to be identical in their nature with Bills of Exchange, is utterly erroneous, because we have abundantly shewn that the best authorities did maintain that Bills of Exchange were circulating medium, and it was only in 1840, that the opposite opinion prevailed!

48. It was impossible for Sir Robert Peel not to see the inconsistency of his measure of 1844, with his expressed sentiments in 1819 and 1833, that it was inexpedient to limit the issues of the Bank to any fixed amount, because there were times of commercial difficulty, when an increased issue of notes might be the proper remedy. There is no doctrine more strenuously insisted on by the Bullion Report, by the statesmen of 1819, as well as by the Government in 1833, and Sir Robert Peel himself, at both these periods, than that it was impossible to fetter the discretion of the Bank in its issues. Sir Robert Peel knew that he was now taking away this power from the Bank altogether, and accordingly he was obliged to meet this objection. He said:

"It is said that the Bank of England will not have the means, which it has heretofore had, of supporting public credit, and of affording assistance to the mercantile world in times of commercial

* Theory and Practice of Banking. Chaps. viii. and ix.

difficulty. Now, in the first place, the means of supporting credit are not means exclusively possessed by banks. All who are possessed of unemployed capital, whether bankers or not, and who can gain an adequate return by the advance of capital, are enabled to afford, and do afford that aid which it is supposed by some that banks alone are enabled to afford. In the second place, it may be a question, whether there be any permanent advantage in the maintenance of public or private credit, unless the means of maintaining it are derived from the *bona fide* advance of capital, and not from a temporary increase of promissory notes, issued for a special purpose. Some apprehended that the proposed restriction upon issues will diminish the power of the Bank to act with energy at the period of monetary crisis and commercial alarm and derangement. But the object of the measure IS TO PREVENT (so far as legislation can prevent) the recurrence of those evils from which we suffered in 1825, 1836, and 1839. IT IS BETTER TO PREVENT THE PAROXYSM than to excite it, and trust to desperate remedies for the means of recovery."

Sir Robert Peel, therefore, deliberately took away the power of the Bank to act in extreme occasions, under the impression that this Act would prevent these extreme occasions from arising. We shall see how this hope was fulfilled.

49. We shall now state the mode in which the currency principle was attempted to be carried out. It was calculated that the commerce of the country would never require less than £14,000,000 in any event, to carry it on with. The Bank was allowed to issue notes to that amount, based upon government securities, and all above that amount solely on the basis of bullion deposited with the Bank. So that for every five sovereigns deposited with the Bank it might issue a £5 note, for every five sovereigns taken away from the Bank a £5 note must be cancelled.

50. It was supposed that this plan carried the currency principle into exact effect, and that by its means the paper notes in circulation would be exactly equal in amount to what a metallic currency would have been without them. It was also alleged that the "currency principle" being carried into effect, banking business could not be too free,

and a great distinction was drawn between "banking principles" and "currency principles."

51. The slightest reflection will shew the singular error committed by the framers of the Act. Because it is quite evident that the £14,000,000 of bank notes are *an addition* to the metallic currency. These are issued against public securities. But how were the public securities obtained by the Bank? By purchasing them with gold. And as the gold that purchased them is in circulation, and the £14,000,000 of bank notes are ALSO in circulation, it is quite evident that the notes are just so much in excess of the existing metallic currency, just exactly as the original £1,200,000 notes issued to represent its first capital was in excess of the existing metallic currency.

52. But this is not the only error of the theory of the framers of the Act. They talked a great deal of the distinction between "currency principles" and "banking principles," and Sir Robert Peel said that bankers should only make advances out of *bonâ fide* capital and not by creating promissory notes. Now, it is perfectly manifest that neither Sir Robert Peel, nor any of his advisers, had the remotest conception of what banking consists. We have shewn over and over again that *banking consists in the creation of currency*. That it does so now, as much as it ever did, only that the *form* is changed, and that the distinction between currency principles and banking principles could only proceed from persons who were totally ignorant of the routine business of banking! The ordinary business of banking in London consists in the *creation of millions of promises to pay!!* And these are estimated at nothing by the framers of this wonderful Bank Act!

53. The famous Bank Act, then, of 1844 is framed on this theory, that "*Twice fourteen millions is equal to fourteen millions, and an indefinite number of millions are equal to nothing!!*" The world has not yet done laughing at the vote of the House of Commons, that 21 was equal

to 27. What will it say of the theory of the Bank Act of 1844?

54. The first trial of the Act took place in the spring of 1847. In consequence of the enormous failure of the potatoe crops in these islands, immense quantities of grain had to be imported, which had to be paid for in money. In the middle of September, 1846, a steady and continuous drain of bullion set in, but the Bank made no alteration in the rate of discount till January, 1847, when, having lost nearly three millions of bullion it raised its rate from 3 to $3\frac{1}{2}$. This, however, had no effect in checking the drain, which proceeded with accelerated rate, and by April the Bank had lost $3\frac{1}{2}$ millions more, but the notes held by the public had scarcely diminished at all. The whole of the reduction took place in the *reserve of notes held by the Bank!* In August, 1846, the bullion in the Bank was £16,366,000, the notes held by the public were £20,426,000, and the notes in reserve were £9,450,000; in April, 1847, the bullion was £9,867,000, the notes held by the public £20,243,000, and the notes held by the Bank £2,558,000; consequently, though the bullion held by the Bank had diminished by $6\frac{1}{2}$ millions, the notes in circulation had only diminished £200,000! So much for the Act of 1844. When the public saw that the whole banking resources of the Bank were reduced to £2,550,000, a complete panic seized them. During some days it was impossible to get bills discounted at all. The rate, even for the best bills, rose to 9, 10, and 12 per cent.

55. This severe monetary pressure produced its natural effect. The exchanges turned in favor of the country. On the 24th April, bullion began to flow in. The conduct of the Bank on this occasion during the winter of 1846-7 while the exchanges were adverse, was the exact counterpart of what it had done on so many previous occasions. For a long period it persisted in keeping its rate of discount below the market rate, so that a rush for discounts was made upon it, and no sooner were these obtained, than the holders of the notes went to the issue department, and demanded gold for them.

56. During the spring, wheat had touched the price of 131s. a quarter. Immense importations were ordered at this price, which were so abundant, and the reports of the potatoe crop being very favourable, the price of wheat fell to 49s. 6d. in September. Then began the terrible catalogue of failures. House after house, and bank after bank, came down. On the 2nd of October, the directors began to be alarmed for their own safety, and adopted the most stringent measures. And now, was tested the theory of the framers of the Bank Act, who maintained the currency principle.

57. The continued and ever-increasing severity of the crisis caused deputation after deputation to be sent to the Government, to obtain a relaxation of the Act, and on Saturday, the 23rd of October, the final determination of the ministry to authorise the Bank to issue notes beyond the limits prescribed by the Act, was taken, and communicated to the Bank, who immediately acted upon it, and discounted freely at 9 per cent. The letter itself was not actually sent till Monday, the 25th. It stated that the Government had expected that the pressure which had existed for some weeks would have passed away, like the one in April had done, by the operation of natural causes; that being disappointed in this hope, they had come to the conclusion, that the time had come, when they ought to attempt, by some extraordinary and temporary measure, to restore confidence to the mercantile community. That for this purpose, they recommended the directors of the Bank of England, in the emergency, to enlarge the amount of their discounts and advances upon approved security; but that, in order to restrain this operation within reasonable limits, a high rate of interest should be charged, which under the circumstances, should not, they thought, be less than 8 per cent. That if such a course should lead to any infringement of the law, they would be prepared to propose to Parliament, on its meeting, a Bill of Indemnity. This letter was made public about 1 o'clock on Monday, the 25th, and no sooner was it done so, than the panic vanished like a

dream! Mr. Gurney stated that it produced its effects in ten minutes! No sooner was it known that notes *might* be had, than the want of them ceased! Not only did no infringement of the Act take place, but the whole issue of notes, in consequence of this letter, was only £400,000; so that while at one moment, the whole credit of Great Britain was in eminent danger of total destruction, within one hour it was saved by the issue of £400,000.

58. So much for the wonderful Bank Act! Never was a more complete demonstration of the wisdom of the Bullion Report, and the great writers on Currency of that period. Mr. Thornton's prophetic words would have infallibly proved true. If the Bank Act had not been suspended, universal failure would infallibly have occurred. The Bank was obliged to follow the principles of the Bullion Report, and the country was saved. What an admirable commentary upon the wisdom of Sir Robert Peel's advisers, who had seduced him from his opinions of 1819!

59 Time passed on, and things resumed their usual course. Nothing particular occurred till the autumn of 1855, when another very severe drain of bullion took place. On the 28th of June, the bullion stood at £17,429,435, when a severe and unexampled drain took place. On the 18th October, it was reduced to £11,205,855. But happily different counsels now prevailed in the management of the Bank. The rate of discount was rapidly raised, and though of course there was some pressure, yet by this wise conduct on the part of the Bank, no panic took place, and everything passed off smoothly.

60. Ever since that time money has been unusually dear, but there was no panic, and the advocates of the Bank Charter Act have taken immense credit to it for that fact. They have uniformly asserted that it was owing to the Act. But this assertion cannot be tolerated for a moment. It is owing entirely to the good management of the Bank, which has at length learned that the

rate of discount is the true method of controlling the paper currency. In order to make good the assertion that the quietness of the country was owing to the Bank Act, it is necessary for them to establish the fact that *the Bank would have misconducted itself without the Act*. Unless they can prove that it was owing to the Act that the Bank conducted itself on the principles of common sense, their assertion is absurd.

61. The fact is, that the framers of the Act of 1844, were not only totally ignorant of the routine business of Banking, but they had not the remotest glimpse of the true principles of monetary science. The consequence is that they made such an extraordinary compound of an Act, that there is no man of common intelligence, who bestows the necessary attention to study its details, who would not be amazed at its absurdity. The plan of basing a paper currency on the funds and the currency principle are directly contradictory to each other. They attempted to carry out a theory in defiance of all authority and all experience, a theory which had been repeatedly tried before and had invariably failed. A theory which had once before brought the Bank to a suspension of cash payments, and would have done so a second time if it had not been abandoned just in time. And there cannot be a doubt that it would have done so in 1847, if it had not been abandoned then.

62. And as we are writing these very words it has again broken down disgracefully, and we believe finally. American banking is purely based upon John Law's Theory of Money, which we have demonstrated to be erroneous in a preceding chapter; we have there shewn that it must end in ruin, and our words have just received a terrible confirmation. All America is now one vast scene of desolation, ruin, and bankruptcy, entirely owing to a false theory of currency. Discount has risen to 36 per cent. Instantly this caused a great flow of bullion to America, as we have shewn must be the case. The

Bank acted with commendable vigor. The rate of discount was raised with unprecedented speed. But if discount is 36 per cent in America, it is vain to think that 10 per cent. in England can arrest the flow. In the meantime almost all the great American houses in this country have come down. Three banks of the first magnitude have fallen, and for the first time in history, a banking panic has seized the people of Scotland. Some millions of gold have been sent to Ireland and Scotland, and by the Act of 1844, an exactly equal quantity of notes have been cancelled. In the meantime, while ruin was rapidly overspreading Europe, the advocates of the Bank Act were crying out on no account to violate the Act. Whatever went, the Bank Act was to remain inviolate.

*" Si fractus illabatur orbis
Impavidum ferient ruinæ."*

63. While the advocates of the Act were calling upon every man of honor to adhere to the Act, the panic began to spread to London. A bill broker with liabilities said to exceed three millions, stopped, and a run was commencing on the Joint Stock Banks, when on Thursday, the 12th November, the government sent a letter to the Bank authorising them to issue notes to an unlimited extent on approved securities, at a discount not less than 10 per cent. Thus, on the second occasion when the season of trial came, the Act was suspended!! And there can be no possible doubt, that if it had not been suspended not only every mercantile house in Great Britain would have stopped, but the Bank itself would have stopped, as happened in 1797. Thus, is this absurd theory of the currency principle blown for ever to atoms.

64. The framers of the Act take credit that it preserved the convertibility of the note in 1847; but this must be received with a very important qualification. There never was any question of the convertibility of the note then—so far from the note being discredited, it was

Bank notes that every one was so eager to get. If the note had been discredited, if there had been a run for gold in exchange for notes, we very much doubt that the Act would have preserved the convertibility of the note. For, if the note had really been put in danger, the only way it could have been saved, would have been by the sale of public securities. But it is extremely doubtful whether the Bank could have sold public securities for gold in the great pressures of 1847, without causing such a ruinous depression of them, as would have been most injurious to the public interests. We believe that the mode of expression more nearly applicable to the state of the case was, that *if* the Bank note had been discredited, there was a greater stock of gold to meet the run, than there would have been without it.

65. The fatal blot, then, of the Act of 1844 is, that it leaves the door open for exactly the same mismanagement which had brought on so many calamities before. Not only does it fail in preventing—contrary to the expressed anticipation of its framers—commercial and monetary panics; but when they occur, it adopts the method most certain to aggravate their violence and intensity. For, when the resources of the Bank are already brought too low, it brings on them a demand for notes far greater than the wants of commerce require. People wish to get notes simply for the sake of self-preservation; then they hoard them, and keep them out of circulation. The most eminent witnesses said that between £4,000,000 and £5,000,000 of notes were hoarded, through the panic in October, 1847; but when everybody knew that they might get them, even at a very high rate of discount, the panic passed away, and an issue of £400,000 was sufficient to satisfy the public necessity. No man in business would not rather pay 20 per cent. discount for a supply of notes in some great emergency, than not have them at all. Now, as all the greatest statesmen protested against fixing a *numerical* limit on the issues of the Bank, because it imposed a prevention on the Bank acting in certain great

emergencies; and as Sir Robert Peel only justified his imposing a numerical limit on its issues, because he anticipated that the self-acting working of the Act would prevent those emergencies arising; and seeing that the expectation was wholly falsified, it follows, as a necessary consequence, that the whole machinery of the law should be altered. Moreover, the ministry themselves gave the preference to determining the rate of discount, rather than the numerical amount, in the great crisis of 1847. For those who urged them to relax the Act suggested that the limit should be placed upon the quantity of notes issued; but the Government most wisely, and acting upon the fundamental principles of the science, left the numerical amount free, but limited the rate of discount; and what was the consequence? £400,000 of notes stayed the panic! Now, we venture to affirm, that if they had adopted the other alternative proposed to them, and if the commercial world had seen that the total relief was limited to a paltry £2,000,000, it would have a very small effect in allaying the demand. The probability is, that they would have been soon absorbed. The same course was adopted in the crisis just passing away; as the bank notes were rapidly diminishing, everybody rushed to get them, nobody would part with them. Consequently, everything was just on the eve of a deadlock, when the Government letter appeared, *authorizing unlimited issues, but at a very high rate of discount*. The happiest consequences immediately followed, the panic was arrested, and confidence was restored. Hence we "conclude that reason, evidence, and experience combine to demonstrate that" it is a false and dangerous principle to fix the numerical amount of paper issues, and that THE ONLY TRUE METHOD OF REGULATING THE PAPER CURRENCY IS BY A PROPER ADJUSTMENT OF THE RATE OF DISCOUNT.

66. The fact is, that the currency principle is utterly absurd. No doubt countries may flourish, and attain to wealth where it was enforced, just as they did before the

days of steam engines. But nobody would now dream of putting down steam engines, although sometimes they do burst and destroy people. Now, banking is to commerce, precisely what the steam engine is to machinery. To carry out the currency principle in all its integrity, it is absolutely necessary to abolish banking. Not bank notes only, *but cheques must be abolished*. To wish to carry out the currency principle shews the most utter want of acquaintance with monetary science; to suppose that the Bank Act of 1844 does carry it out, shews the most entire misconception of the ordinary business of banking; and actually to carry it out, would immediately destroy one-half of the commerce of Great Britain. To carry out the currency principle in all its integrity would be as rational as an attempt to put down steam engines.

67. The time has now come when the whole question must be solemnly and deliberately reinvestigated by parliament. It remains to be seen whether it will be done in a large, unbiassed, and philosophical spirit, or whether they will allow themselves to be beguiled by a knot of persons who have utterly corrupted the language of Political Economy—who have landed them in an Act, founded upon principles of law which would excite the ridicule of the pupil room of every special pleader in the Temple, and on an ignorance of the routine business of banking which would raise the laughter of a club of bankers' clerks! Who by the unnatural union of the dangerous fallacy of John Law with a principle which has been expressly condemned by all the great authorities of former times, have produced a hybrid, a monetary monster, which will be the amazement, the wonder, and the ridicule of all future ages! We at least have done our duty. Watchmen on the lonely tower, we have proclaimed the danger and the absurdity of these incongruous elements. What the result will be remains to be seen. One thing at least we fervently trust—That parliament will immediately exterminate the desperate madness of Lawism—of the principle of basing paper currency upon the public funds,

from our monetary system. Let it not countenance the doctrine that a man can buy a thing and have the price of it as well. Let it not lend the name, the sanction, and the authority of England to the smallest fragment of that insane delusion, the effects of which carried out to its legitimate conclusion, are now causing the civilized world to reel to its foundations.

THE END.

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